FINANCIAL CHAPTERS OF THE WAR

BY

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PREFACE

THE purpose of this book is to describe clearly, and explain without technicality, the remarkable financial and economic episodes which have attended the European War. The general public understood perfectly, from the very first days of the conflict, that its economic results were certain to be as momentous as its political results. But the most experienced financiers were at loss to say beforehand what the financial character of the war would be. When it began, they found it equally impossible to measure the real significance of the first economic occurrences. It is hardly surprising, therefore, that the general public should have been unable to understand what had actually happened. Financial events were in fact so extraordinary and complicated as to leave the mind of many readers of the news in complete bewilderment.

It is my hope that these chapters may serve to clear up that perplexity Perhaps no questions have been asked more frequently since July, 1914, than the questions how the fighting nations have been able to raise the $100,000,000 per day which

they are spending on war; why the seemingly convincing prophecy of the shortening of war because of economic exhaustion has not been fulfilled; what was the meaning of that "depreciation in the foreign exchanges" of which we have heard so much; whether Europe has lapsed into irredeemable paper currency like that of our Civil War, by what means the United States—largely dependent on Europe, in a financial way, before the war—should so suddenly have acquired the power of paying off its foreign indebtedness, financing neutral nations from its own resources, and lending even to belligerent Europe larger sums than Europe itself had raised for its earlier wars. Along with these considerations came the further inquiries: Is this American war-time prosperity unreal, temporary, and fictitious? Will the conditions of 1915 and 1916 be instantly reversed when war is over? Has New York actually displaced London as the financial centre of the world? On these questions I shall endeavor to throw some light.

It would be presumptuous for any one to claim ability to answer all of them. One reason why this book bears its present title, instead of being described as a financial history of the war, is that the actual and relative importance of many economic phenomena of the period cannot be determined conclusively until the war itself is over.

But it is possible at least to give to the general public the means of understanding exactly what has happened already. Every reader of history will agree with me that the lack of clear contemporaneous exposition of the financial events of our own war from 1861 to 1865, or, even more particularly, of the great Napoleonic wars, is one of the greatest obstacles to the full historical comprehension of those episodes.

I have drawn freely in this book on my previous discussion of the same subjects in *Scribner's Magazine*, and have also utilized an article written by me last autumn in the *Yale Review*. But with the recent rapid movement of events, economic as well as military and political, it will readily be understood that all previous comment had to be rewritten, and that the greater part of this book should be made up of previously unpublished matter.

A. D. N.

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CONTENTS

CHAPTER I

PRECEDENT AND PREDICTION

BEFORE the European War broke out, the most familiar answer of the banking community, to predictions of such a war, was that the economic consequences would be so terrific as to deter any statesman or ruler from committing his country to them. After the fighting had begun, prediction was quite as general to the effect that the war must necessarily be short, because none of the belligerents would be able to endure the financial strain. In concrete terms, this forecast usually shaped itself in the statement that economic exhaustion could not fail to reach, by the end of 1915 at any rate, so acute a stage as to compel the ending of hostilities.

Both predictions we now know to have been entirely wrong, and they were not more promptly and completely refuted by the course of events than were the prophecies of specific phenomena, military or financial. These facts cannot well be ignored in attempts to forecast the still weightier problems which will arise on return of peace Prediction of those later results, whether based on

experience of history or on particular circumstances of the day, has no greater presumption of infallibility than the predictions of immediate results in 1914 Certainly no more baffling and bewildering question has been presented for a century past, in the field of political and economic history, than the question what is to be the aftermath of the present war. Politically, problems are involved of so complicated a nature that the forecast even of the most experienced European statesman could not be better than a guess. As a matter of fact, statesmen have risked no such predictions, but have restricted themselves to general expressions of their hope or purpose, such as "the insuring of permanent peace in Europe" or "the ending of the burden of militarism." As to precisely what measures would or could insure these wished-for consummations, on any supposition regarding the military outcome of the war, the public men were silent. The post-bellum territorial readjustment, post-bellum conditions in the internal politics of the states now indulging in so unparalleled sacrifice of blood and treasure, were sure to be powerful factors in determining the future; yet even as to these, we had only such vaguely formulated suggestions as the "realizing of Russia's aspirations in the Bosporus," the "creation of an autonomous Poland," or the "recovery by France of her lost provinces."

As with the political sequel to the war, so with its financial and economic sequel. In both directions forces of incalculable magnitude had been set loose in this epoch-making conflict, and their effect on the political and economic structure of Europe was rendered more utterly novel a problem by the extremely complicated character which international relations of every sort have assumed in the past generation When the aggregate daily military expenditure of the belligerent powers had become ten times as great as in any previous war of history; when the European states, already burdened with the accumulated public indebtedness of the past half-century, doubled or trebled that debt within two years; when the mere annual interest charge on the new indebtedness may presently exceed the total yearly public revenue of the several belligerent states in the year before the war, it is scarcely surprising that the financial community itself should have listened to any theory promulgated as to conditions after the war. Even in the plans and discussions of practical business men, this unknown future gradually assumed the aspect of something terrible because it was unknown. The formula of Preparedness, which very soon occupied a front place in legislative controversy, with neutral states even more than with belligerents, embodied the popular concep-

tion, not of conditions which must in the nature of things arise when the war is over, but of conditions which the imagination pictured as possibilities. Seeing that high experts either disagreed diametrically in their predictions, or else confessed their inability to predict at all, it was perfectly natural that imagination should have drawn some startling pictures, yet that the pictures should have differed absolutely from one another.

Financial as well as political observers had, it is true, the voluminous history of the world's great wars on which to base conclusions. Among other precedents, the financial sequel to the outbreak of our own Civil War was not without possible suggestions. Delegates from the seceding States had, on February 8, 1861, met at Montgomery and formed the Southern Confederacy. It was not, however, until after Lincoln's inauguration on March 4, when the certainty of war began to be recognized, that the banking crisis actually developed. In April banks at all the Northern cities temporarily deferred cash payments; in May the Southern banks suspended specie payments altogether, and the new Confederate Government officially forbade payment of debts by Southern to Northern houses. The Northern dry-goods trade fell into panic; merchants' paper being discounted at the banks for as high a rate

as 3 per cent a month. Yet the crisis seemed to have been overcome until the gold of the country began to be rapidly drained away on export in the autumn On December 17 the New York banks concurred in a formal resolution that the situation gave "no reason, justification, or necessity for a suspension of specie payments", but less than a fortnight later they took precisely that action, and the country was soon committed to the irredeemable government paper currency, for which redemption in coin was not provided until seventeen years later, more than thirteen years after the ending of the war.

One or two of these incidents had a bearing on the possible course of economic events in the European War, and we shall find some interesting analogy in the manner in which, contrary to all prediction of financial markets, the enormous war loans of our Civil War were floated. But with those points of very general resemblance, the economic parallel ends The war of 1861 was a purely domestic struggle; the commerce of the United States was unimpeded; we raised money freely by the sale of our new securities to the outside world. No real analogy with the circumstances under which this present war broke out could in fact be found, short of the Napoleonic conflict of a century ago. Twelve nations were simultaneously at war in 1815; twelve were at

war exactly a hundred years later; nothing approaching a contest with such scope had occurred in the intervening period. In none of the wars since Waterloo had campaigns been simultaneously fought by European colonists on other continents, and in remote parts of the world. In none of them had sea fights on the coast of South America or Australia divided interest with battles in the centre of Europe.

At the very beginning of the present war was duplicated that episode which has so often seemed incredible, and which even the historians describe as a "barbarous decree"—Napoleon's seizure and imprisonment, for a dozen years after his declaration of war in 1803, of 10,000 English tourists and residents in France. The struggle of the small neutral states of Europe, after 1805, between the upper and nether millstone of the powerful belligerents reads like a chapter from last year's history of southeastern Europe. The English capture of Copenhagen and its fleet in 1807, at an hour when Denmark was not at war with either side, but merely balancing between alliance with the English or the French, can nowadays be better understood by those who have watched the recent predicament of Greece.

For a hundred years, readers of history have looked back with astonishment to the 10 per cent tax levied on English incomes at the opening of

the nineteenth century. To-day incomes of English citizens pay 25 per cent and upward to the government. "Pitt's subsidies" have reappeared on an immensely expanded scale in the $1,500,000,000 advanced for war purposes by England to her allies in a single twelvemonth Since July, 1914, the world has again, for the first time in more than a hundred years, seen captured cities in the heart of Europe deliberately given to the flames, citizens held for hostage, tribute imposed on non-resisting towns occupied by the enemy—occurrences which were supposed, with the civilized world's formal adoption of a humane code of international relations, to have been relegated to the limbo of other centuries. Even the chapter in the story of Napoleonic Paris at which later generations have smiled—the hysterical outcry over the "English lies" to which was ascribed unpleasant news about the war—has been reproduced to an admiring world by twentieth-century Berlin.

In no respect was the parallel more startling than in the great collision over the rights of neutral ships, which repeated, step by step, the story of the "Orders in Council," the "Berlin Decree," and the "paper blockades" of the Napoleonic conflict. During the whole of 1915 the greatest of the neutral Powers lived over again, with remorseless coincidence of causes and yet

with the most impressive contrast of circumstance, the long series of episodes which led up to our War of 1812; the historical parallel lying not only in the fact of two European antagonists, in the earlier period, interfering with our commerce in order to injure one another, but in the further fact that both of them on that occasion, like one of them in the present instance, conditioned their own suspension of unlawful attacks upon our vessels on our government's inducing the other belligerent to stop blockading its European enemy—a proposal of which President Madison, anticipating President Wilson's attitude, bitterly remarked to Congress that it was tantamount to "asserting an obligation on a neutral Power to require one belligerent to encourage by its internal regulations the trade of another belligerent." With political, military, and financial events repeating with such dramatic accuracy the story of the Napoleonic wars, it might surely have been assumed that even the economic history of the present war, during the period of hostilities and afterward, could have been foretold from the records of a century ago

One reason, recognized from the very start, why this process of analogy was bound to fail, lay in the prodigious cost of war to-day. As to what that cost would be, political statisticians and military experts had for years been busy estimat-

ing Our own War of Secession cost the United States Government $1,000,000 per day in its early stages and $3,000,000 daily during and after 1863. An official French report of January, 1871, reckoned the current daily expenditure of France for the war with Prussia at $3,200,000. The little Transvaal War, lasting from October, 1899, to June, 1902, cost England $1,085,000,000, or a million dollars a day. Japan and Russia spent between them $3,500,000 daily on the Manchurian War of 1904 When the question of a possible "general war" came into anxious controversy in the last-named year, a well-known French statistician, M. Jules Roche, calculated that in a conflict involving two or three great Powers the average daily cost for all combined would be about $6,000,000, but that a war in which France, Russia, Germany, and Austria were all engaged would cause a total average expenditure, for purely military purposes, of $18,000,000 per day.

The somewhat earlier estimate of an Austrian economist had figured that participation in a European war would cost France $5,100,000 per day, Russia $5,600,000, Germany $5,000,000, and Austria $2,600,000. In 1913, when the Balkan War once more revived speculation as to the possibilities of a general conflict, Doctor Charles Richet, of the University of Paris, on the basis of a very elaborate calculation, estimated that if

Germany, England, France, Russia, Italy, Austria, and Rumania were all to engage in war, the actual average expense of the campaign per day would be $54,100,000. This estimate, it will be observed, came very close to naming the actual belligerents of 1914. Even when republished at the outbreak of the present war, the figure was commonly regarded as incredible. Yet exactly a year after hostilities had begun, the German imperial chancellor told the Reichstag that the daily cost, to all the Powers involved, was $75,000,000. The daily expenditure of England and Germany alone in the middle of the present year was greater than Doctor Richet's estimated outlay for all seven belligerent Powers, and the estimate of international bankers in June, 1916, as to the total daily outlay by all the European belligerents combined, was $103,000,000.

Now, the average daily cost to England of the entire Napoleonic War was less than $2,000,000, as against the $25,000,000 average which it has reached this present year. It is true that the national wealth has increased at an almost equal rate. But, on the other hand, when Pitt placed his 10 per cent tax on English incomes in that earlier period there had been no income tax at all in England, whereas English incomes, early in 1914, were already paying what was traditionally called a "war rate" of taxation. The cost of war

to Napoleon was trifling compared with the expenditure of continental belligerents to-day. It was possible for him to tell the Directory at Paris that the $4,000,000 "contribution" imposed on Lombardy in his Italian campaign, and the $2,400,000 exacted from Parma and Modena, had paid the cost of war. The $8,000,000 indemnity exacted from Vienna after Austerlitz came very near to serving a similar purpose in the campaign of 1805. The imitation of this procedure by the German generals, in their Belgian campaign of 1914, was not even mentioned at Berlin as a help toward paying war expenses. It had no effect whatever, except to expose the authors of the cruel exaction to the scorn and contempt of the outside world.

But the vastly larger cost of present-day warfare was not the only consideration which prevented drawing of confident analogies from the economic results of war a century ago. When the treaty of Amiens between France and England was broken in 1803, international finance and international foreign trade were in their infancy. Judged by its scope and methods of to-day, foreign commerce was conducted in a fashion which may fairly be described as primitive. International banking and investment were hardly in their beginning; the house of Rothschild, for example, dates its origin from the days of disordered

continental finance and great English public loans which came with the Napoleonic wars. No belligerent state, therefore, was confronted with enormous sales, on its stock exchanges, of securities held in the enemy markets. As a matter of fact, the London Stock Exchange remained open during the whole of the Napoleonic wars; not even such precaution as arbitrary "minimum prices" was imposed by government. The price of Great Britain's 3 per cent consols did indeed decline from 80 or 90 to the neighborhood of 50; but it was lowest at the beginning of the war. Thereafter, notwithstanding the then unprecedented output of new government securities by England, the price of consols rose and fell purely in response to news from the campaign; in general, the price was considerably higher than at the beginning of hostilities.

Government bonds were indeed almost the only quarter in which the rapidly accruing capital of Europe could be invested; at London, the only alternatives of real importance were the very limited field provided by shares of the Bank of England and the East India Company, and the very speculative and precarious field provided by joint-stock ventures in merchant ships and cargoes. The extremely intricate problem, created in 1914 by the enormous mass which every strong belligerent country held of securities and floating

loans of foreign, including enemy, communities, did not therefore exist at all. But, on the other hand, the strain on the gold reserves of the fighting nations was most formidable. At London almost the first financial event in the long French war of a century ago was suspension of gold payment on its circulating notes by the Bank of England. An open premium of 20 to 40 per cent on gold was the necessary consequence; then a discount of 16 per cent or more on English drafts presented in the foreign exchange markets of such great commercial cities as Amsterdam and Hamburg.

Merchant vessels sailing for other destinations than these banking centres carried gold and silver in their strong boxes, and, though they commonly moved in convoy, escorted by ships of war, they were the rich prizes of the maritime campaign. An extensive smugglers' trade, with headquarters in the Channel Islands, largely defeated the blockade of France and its possessions by the British fleet. One of the incidents of that war was the establishment, from the unguarded seaports in Finland or Dalmatia, of a land route through which, in wagons or sledges drawn by relays of horses, contraband merchandise was carried from England across the Continent to Germany and France—at a cost said to have been fifty times the freight rate, then existing, from London to Cal-

cutta. In short, the confusion into which the present war plunged international finance, directed itself a century ago to ocean trade. Such international banking problems as existed were created wholly by this exchange of merchandise.

When the British Government, during the Napoleonic wars, paid its famous subsidies to the German states, the most efficient means of doing it was found to be through a three-cornered operation, based on the foreign trade of the United States. With neither of the great belligerents in control of the sea, and with French and English frigates cruising along the ocean routes to capture enemy merchant ships, the merchants of neutral America, whose export trade in products of the United States was small, developed a lucrative business in carrying West Indian products to England and continental Europe and bringing back English manufactures for home consumption. On the English markets, these merchants bought far more than they sold; on the Continent they sold far more than they bought. The British Government therefore bought from the London merchants their claims on American importers and sent them to the German money markets, where the American traders' claims on German merchants were accepted in payment; such mercantile drafts on Germany being then used for payment of the

British exchequer's subsidies to the German princes.

It was not difficult to see, even in August, 1914, how little of sure analogy as to probable economic results in the new European War could be based on these experiences of the last great conflict of a similar scope. The immense expansion of international trade and banking which had marked the century since the battle of Waterloo; the complete change which had occurred in the investment of capital, the enormously complicated machinery of debits and credits, assets and liabilities, as between all of the great financial markets—these were aspects of the situation such as could only confuse and bewilder the financial mind. It was perfectly evident when this war began that, whatever were to be the actual economic phenomena created by it, they would not be the comparatively simple problems of 1793 and 1803 and 1812, but something vastly more difficult for the financial markets to surmount without world-wide collapse of credit.

Since, then, we have seen how little light history could throw on the probable economic events of the war of 1914, it will be interesting to inquire what experienced financiers expected to occur as an immediate consequence of its outbreak. Minds of the greatest bankers, in every market of the world, had been absorbed in this question for

a generation. Despite their incredulity as to the willingness of any government to provoke such a war, the possibility was never absent from their calculations. The largest financial interests in the world were at stake in their judgment as to the immediate economic sequel.

The question, what results they actually looked for, is not at all difficult to answer. It was well understood beforehand that, in the economic as well as in the military field, forces would be called into play such as would test with the utmost severity the financial endurance of the belligerent communities. But, as regards specific results, the course of events in the world's economic history since the war began, as in the strategy of the war itself, has been a chapter of surprises. With a single exception—the French calculation, already referred to, that a war involving six European Powers would cost at least $50,000,000 per day, which has been more than realized—every prediction of the immediate financial and economic sequel hit wide of the mark.

First, general insolvency would be inevitable, with bankruptcy of the most important international houses—owing to the sudden embargo on collection of the enormous mass of credits outstanding to their account in other countries. That prophecy has not been fulfilled at all; there have been fewer of such bankruptcies, either in bellig-

erent or neutral states, than in an ordinary "panic year" like 1866 or 1873. Second, outbreak of general European war would break down international trade completely; partly because of the crumbling away of credit, partly because of hostile navies on the sea. As late as July 23, 1914, only a week before the German ultimatums, Sir Edward Grey predicted to the British ambassador at Vienna that "if four great Powers—say Austria, Russia, France, and Germany—engaged in war, the war would be accompanied or followed by a complete collapse in European trade and industry." All of the designated great Powers, and with them England and Italy, have been for two years at war; yet, except for the foreign commerce of Germany and Austria, the prediction is unfulfilled. The problem of the commercial world to-day is a problem, not of available supply and demand for merchandise in foreign trade, but of available ships to carry it.

Third, liquidation of Europe's investments in neutral countries, with a view to raising money for the war loans, would proceed on such a scale as to force a 20 or 30 per cent break in the price even of American securities (of which the outside world held something like $4,000,000,000), with all the financial consequences which such sudden change in basic values would involve. With the unprecedented war-time output of new government

securities in Europe, demand on the whole world's investment capital would so immensely exceed available supply as to make this decline in existing securities progressive, even in the markets of neutral states The prediction has wholly missed fulfilment. Belligerent Europe has in actual fact sold back to the United States during the progress of the war more than $1,500,000,000 of American securities; yet prices for American stocks and bonds, after eighteen months of fighting, were higher than when the war broke out, and, instead of the predicted panicky break on the stock exchanges, the second year of the European War was distinguished on the American markets by an exceedingly violent speculation for the rise.

Finally—and this belief persisted during several months of the war itself—the wholesale recall of belligerent Europe's capital from neutral markets, and especially the throwing back upon them of the securities previously sold by them to Europe, would result in drawing all the gold of neutral states into the European banks, with resultant collapse of bank reserves in such neutral markets, complete upsetting of their credit, and extreme advances in their money rates. None of the prophecies has been so amazingly falsified as this. Not only was the American market's importation of gold, in 1915, larger by $300,000,000 than in any previous year of its history, with

the inflow continuing during 1916, but the accumulation of gold in such other neutral states as Holland and Sweden was so abnormally rapid that, reversing all previous financial practice, measures were actually taken by the banks of those two countries to discourage further imports, lest the mere fact of overflowing bank reserves should provoke unwholesome speculation. Reserves of the American banks passed far beyond their previous maximum. As for the money market, New York was destined to be confronted, after 1914, with one of the longest consecutive periods of extremely low money rates in its history.

Such was the series of erroneous and misleading expectations with which the whole financial community of the world, and especially that of England, entered the period of war. It will now be our task to survey the actual course of economic events; to inquire why results unexpected by the most competent financiers actually came to pass and why the expected results did not, and then to see how far, on the basis either of past or present experience, we can map out the horoscope for the aftermath of war.

CHAPTER II

THE WAR PANIC

WITH what spectacular suddenness the great European War, for whose possible occurrence financial Europe had during forty years been watching apprehensively, at last broke out at the end of July, 1914, no one who lived through that period is likely to forget. The sense of incredulity; the insistence that such a thing was not possible in our time; the final bewildering whirl of events, remembered by most people only as a cloud of confusion until the German advance on Paris, with the French and English armies retreating before the triumphant invader, emerged as a concrete fact—what all this signified in America it signified in Europe also, and in the great financial markets of Europe as well as among the people at large.

Except for a general sense that events crowded on one another's heels with such rapidity that the latest bulletin of the newspaper "extra" went far toward blotting out recollection of what had gone before, few people even to-day remember what actually happened in that period of confusion. This was, and is, as true of the financial com-

munity as of the community at large. Austria's ultimatum to Servia created, in the hasty view of the reader of the despatches, the sense that a crisis had arisen which, because of its very gravity, must somehow be surmounted. In another week both Austria and Servia were lost to sight in the rush of larger consequences elsewhere on the map of Europe For a single day the firing by the troops on the Dublin rioters seemed to be the event of paramount significance; then it was forgotten for a year. The predicament of American tourists, unable to get away from the area of fighting, held the centre of the news for a period only a little longer. How slowly the comprehension of what was actually happening swept over even the financial mind may be forcibly recalled by the episode of the North German Lloyd steamer *Kronprinzessin Cecilie*, whose departure from New York for a German port on Tuesday, July 28, with $10,000,000 gold on board, consigned one-half to London and one-half to Paris, was discussed on Wall Street with more amusement than concern, as proving the unreality of the talk of war, until the news arrived of her sudden turning back in mid-ocean and of her race to reach an American port before the English cruisers should intercept her.

The French invasion of Lorraine; the declaration of war by England, at which, somehow, no-

body seemed to be surprised; the expectant waiting for an Anglo-German sea fight; the general confidence in the Belgian army's resistance; the vague expectation of another epoch-making battle on the historic field of Waterloo; the early details of the German army's outrages; the fall of Namur and Brussels and the swift forward movement of Von Kluck—no such bewildering panorama had been presented to the eyes and mind of this generation. Only when the American community awoke to its full discovery of the powerful and unanimous sentiment of abhorrence at the German Government's performances—a sentiment destined to grow vastly stronger as the war progressed—did our own people begin to see the chapter of events in its true relations. To the great financial markets, usually the keenest and most accurate judges of the meaning of events, this awakening to the facts of the situation brought, first, a practically unanimous conviction that, with England ranged on the side of France and Russia, Germany's ultimate defeat was certain, and that therefore every German victory must be considered a calamity, not only because of the methods and practises which it vindicated, but because it meant prolongation of the war. But even before arriving at this positive conclusion (from which Wall Street has not turned at any subsequent moment of the war) the finan-

cial markets had to pass through what was unquestionably the most formidable panic of history.

Financial panic, as defined by all previous experience, arises from one or more of four main causes—doubt over the solvency of great fiduciary institutions; sudden withdrawal of the credit on which business men were relying for their ordinary engagements; acute apprehension of a collapse in value of investments; or complete loss of confidence in the currency. The first, if not immediately checked, leads to runs of depositors on banks, to a frantic call by creditors on debtors, and to stopping of payments; the second to a desperate struggle of merchants and bankers to realize on their assets; the third to wholesale cancellation of loans based on stock exchange securities; the fourth to such hoarding of gold as causes the actual circulating money of a whole community to disappear. As we shall see, and as was quite inevitable from the nature of the crisis of 1914, all four causes operated instantly and on a scale never previously witnessed in financial history.

The great panics of the past have been violent in their immediate phenomena, in proportion as the shock caught financial markets off their guard and without a chance to adopt precautionary measures They have been destructive in their economic results, in proportion as it was difficult

to remove the real cause of alarm, or to obtain for one hard-pressed community the help of others which had escaped the panic. The panic of August, 1914, arose from the European War itself, whose formidable consequences were only beginning. Every market in the world fell under its immediate influence; instead of financial relief obtained from foreign countries each panic-stricken community was confronted by the most urgent measures elsewhere to prevent such recourse. Above all, the shock of war and war panic came on an almost completely unprepared and unsuspecting business world.

That no such news as that of July 31 could possibly have been anticipated by the German, French, or English financiers, the $10,000,000 gold shipment of the 28th was striking proof. But there is other evidence to the same effect. What purposes were secretly entertained by the Austrian cabinet and the German general staff, during the two or three weeks (and possibly the two or three years) before the declaration of war, will probably remain a matter of dispute when the inside history of this war is being written half a century hence. The diplomatic communications published by some of the belligerent countries, the obvious suppression of diplomatic documents by others, and the later disclosures by Italian statesmen of the diplomatic suggestions of 1913, cer-

tainly threw sinister light on the attitude of the two central European Powers. But these were considerably later revelations. In August, 1914, the shock came upon the world's great financial markets with as complete a violence and suddenness as it is possible, in an event of such immense importance, to imagine. This fact had very much to do with the character of financial events at the beginning of the war. Financial markets have had a long experience in preparing for the most formidable contingencies, provided they only have had reasonable notice. But it is probable that no other war in modern times—with the possible exception of the Franco-Prussian War of 1870, the circumstances of whose beginning were somewhat like those of 1914—has taken the great financial communities of the world so absolutely off their guard.

Yet the very recent history of the markets gave a curious aspect to the complete surprise with which the outbreak of this war caught financial Europe. The stock exchanges had at intervals been discussing, during at least four decades, a "general European war" as a possible factor in financial calculations. The discussion had for the most part been vague and academic; but in the two or three years before 1914 the apprehension had begun to take something like concrete form. This phase of the matter began in June,

1911, when Germany, with the evident enough purpose of provoking trouble, sent a gunboat to Morocco, where France was engaged in protecting the concessions allowed to her by the Algeciras conference of the Powers; that action being accompanied by a menacing attitude at Berlin, and followed by Sir Edward Grey's declaration to the German ambassador, on July 21 of the same year, that, if the negotiations between Germany and France should fail, "Great Britain would be obliged to take some step to protect British interests"

This was a veiled threat of war—by Germany on France, by England on Germany. Paris bankers had been lending money heavily in Germany; the estimates ran to the hundreds of millions of francs. They began that autumn to recall those loans, with severe money stringency in Germany as a result. Simultaneously, the common people of France began to hoard gold in their old stockings and chimney-pieces; a historic evidence of their belief that war might be inevitable. The "Morocco scare" passed over, but in the autumn of 1912, when the Balkan War began, distinct signs of financial apprehension were renewed. European statisticians estimated that not less than $350,000,000 gold was hidden away by the people of Germany, France, and Austria, even before 1914.

During the whole of 1913 money rates were abnormally high, both on the Continent and at London—largely as a result of this drawing away of gold from bank reserves. But it was evident, especially in London, that capital also was being hoarded. The large bankers and investors showed unmistakable preference to keep their accruing resources and savings on deposit or within easy reach, instead of investing them on the former scale in stocks or bonds of foreign communities, which could not be turned into cash so readily. It happened repeatedly, during 1913, that new issues of foreign public securities of the highest grade, offered by Lombard Street bankers to investors at unusually low prices, were simply not taken at all by the public, but left on the bankers' hands. This phenomenon, which was ascribed at the time to the "world's scarcity of capital," is better understood to-day than it was then The truth, as the next two years proved unmistakably, is that the world's free capital available for investment was as abundant as it had ever been before, but that its owners, in the prevalent atmosphere of vague political apprehension, chose to keep it uninvested until the political horizon cleared.

All this might seem to mean that financial Europe was looking for this war two or three years before it came. Yet it is equally easy to

show that, when the war actually broke out, every European market (possibly with the exception of Vienna and Berlin) was taken completely by surprise as it is to prove that the people at large did not expect it. When war is expected rates for money always rise. But in January, 1914, money rates were reduced at the great state banks of England, Germany, France, Austria, Belgium, Denmark, Sweden, and Switzerland to the lowest figures touched since the Balkan War began in October, 1912. The movement was most unusual for its emphatic unanimity.

This was not all. An even more infallible sign of a financial market's belief in coming war is heavy selling of outstanding government bonds and a rapid fall in their price. The reason is obvious; all experience teaches that the enormous borrowings of a government at war will flood the market with new public loans and beat down the price of older issues. Yet during those opening weeks of 1914, prices for the government bonds of Germany, France, England, and Russia advanced 2 to 6 per cent, German and English markets leading in the movement, and the buying demand for all such securities being extremely active. This extraordinary incident on the markets occurred only six months before Germany declared war. It is an equally striking fact that as late as the middle of July—two weeks before the

ultimatum to Russia and two weeks after the murder of the Austrian archduke—money rates were reported as growing still easier, both in Paris and London. The Austrian stock market, it is true, had fallen into a panicky condition; but even at Berlin the weekly report of a financial journal, as late as July 9, made the interesting comment that "as usual, the Norway voyage of the Kaiser marks the beginning of the dead season in German politics."

When Austria, on Thursday, July 23, sent her note to Servia, making acceptance within forty-eight hours of every one of a series of insolent demands, an ultimatum, prices on the Vienna stock exchange, already very low, declined with something like panicky violence. This of itself was not taken as of great significance; because, whatever might be the possibility of larger complications, Austria was evidently about to make war on Servia and was threatened with war by Russia, and every one at all familiar with the facts knew that the Austrian Empire was in no financial condition to endure the strain of war. When, therefore, on Monday, the 27th, the Vienna stock exchange closed its doors, followed by the government's declaration of war on Servia next day, the outside financial community was still suspending judgment.

Its attitude was not long left in doubt. It is

the commonplace of financial philosophy that the stock market moves as much by instinct as by private information, and the closing of a stock exhange is an evidence of apprehension far more convincing than a fall in prices. It was not until Friday, July 31, that the German Government sent its ultimatum to Russia and France, followed by actual war next day. But on the 27th the Brussels stock exchange had formally suspended business; on the 28th the Paris Bourse shut down; on the 29th the exchanges at Saint Petersburg and Amsterdam closed their doors; and on the same day Berlin itself forbade all further dealings on credit, limiting stock-market operations wholly to cash transactions. During all this seven-day period, sales of securities by Berlin on every foreign market (notably New York) seemed to be limited only by the supply available to sell and the capacity of brokers to execute the orders. Private cables told of the published recommendation, by some of the largest German banks, for their clients to sell at once what they could of their investments. British consols fell from 75 to 69½, and all other international securities fell with them. On August 5, the German army having in the meantime invaded Belgium, England declared a state of war with Germany.

At London, the world's financial centre, financial crisis did not wait for this action by the British Government. It was Germany's ultimatums of

July 31 which made the war inevitable. The first financial result at London was the closing of the stock exchange on that day for an indefinite period. The obvious reason for this sudden action was that markets of every belligerent state on the Continent, realizing the urgent need for ready capital in the coming economic crisis, were selling in London what foreign securities they held—in quantities running high up in the millions of sterling, and at any price obtainable. Government bonds of the South American states, of Russia, Japan, and China, railway stocks of the United States and Canada, were being thrown on London's market by the Continent at declines running in many cases from 10 or 30 per cent within a very few days, the declines becoming more violent every day. On Lombard Street these securities are pledged in immense amounts as security against loans obtained from banks. Although probably less than usual was outstanding in these so-called "stock-exchange loans" when the war began, the subsequent report of a Lombard Street bankers' committee reckoned the total at $400,000,000. Much longer continuance of such a decline in prices would have reduced the borrowers to bankruptcy, because they could not keep the security up to the face value of their loans, and would have crippled the banks because they could not collect the loans

Back of this stood the further fact that London

could not allow Berlin, whose own stock exchange had already virtually suspended operations, to accumulate sinews of war by raising cash on the English market. These various possible results could be averted only by closing the stock exchange entirely; for only through the machinery of such an organized exchange could the huge mass of securities thus offered find a market. London's example was promptly followed by every other stock exchange in the world which had not already closed. New York's shut down an hour after London's, though most reluctantly and in spite of the previous night's formal decision to the contrary. Nothing was more certain than that the closing at London, with New York still open for business, would converge on the American market the whole violence of the Continent's forced sale of securities with equally heavy selling by London itself.

This closing of the stock exchange was in its way a dramatic testimony to the magnitude of the financial crisis; for at London no such action had ever before been taken—not even during the Napoleonic wars. The Paris Bourse had closed down for several months during the Prussian invasion of 1870 and the New York Stock Exchange for ten days in the panic of 1873; but even with those markets it was a very temporary incident of bygone history, whose repetition no

one had predicted. This unprecedented action at London, however, was only the beginning for a series of events which equally marked new precedent.

The two events which would probably have seemed to the financial world most inconceivable, only a week or two before, would have been a run on the Bank of England and a breakdown of public confidence in the English currency. It is true, the history of other countries had proved that when great wars break out, a run on the banks will usually be started by people who want to turn their bank-notes or government paper into gold, and hoard the gold. The teaching of experience, as well as instinct, warns holders of paper money that its value may be heavily depreciated through increased issues of such paper for war expenses, whether by the government or the banks. The run on the Bank of France in 1870, leading to its suspension of gold payments on the currency, and the concerted refusal of the New York banks in December, 1861, to pay out gold to customers any longer, were noteworthy modern instances. In 1797, when the long war between England and France began, the Bank of England itself suspended specie payments; that is to say, it ceased to guarantee redemption of its notes in gold, and did not resume such full and free redemption during the twenty-four succeeding years. In

August, 1914, almost the first financial act by official Germany was a similar suspension of gold payments.

On Saturday, August 1, a run began on the Bank of England. The circumstances immediately surrounding that event were, however, so peculiar as to render it impossible even now to say whether the episode was or was not really in line with the usual phenomena of a bank run During the summer season England sets apart the first Monday of every month as a business holiday. The news of Germany's ultimatum to France and Russia arrived on the very Saturday when London people, preparing for their two-day midsummer outing, were going to their banks to draw the requisite pocket money. The English currency provided no unit of general circulation of a value between the silver half-crown piece worth slightly over 60 cents and the £5 Bank of England note worth $25, except the gold sovereign and half-sovereign. Therefore, without any necessary purpose of hoarding gold, the London people, planning for the holiday, brought their five-pound notes to their banks to be exchanged into gold. A few private banks, frightened at the war situation, refused to give out gold (it is usually such action of bankers themselves which starts a panic), and holders of the notes thereupon went to the Bank of England, which could not refuse.

All such bank runs grow from the very fact that they have begun. How many of the applicants for gold were merely prospective holiday-makers nobody can know; one of the English writers on the episode, himself a "City man," has said that the crowd at the bank was "bruited abroad as a novel spectacle," and was watched "by a throng of amused spectators, mostly straw-hatted and in holiday attire, gathered on the steps of the Royal Exchange." But a run undoubtedly existed, and we shall never know to what proportions it might have risen but for the fact that the bank was open only for two hours on that Saturday, and that a two-day holiday followed. Even as it was, withdrawal of gold from the Bank of England, both by individual holders of notes and by other banks, was so great that in its next weekly statement the institution had to report the enormous loss of $52,500,000, and a fall in its ratio of reserve to deposit liabilities to the startlingly low figure of 14⅝ per cent, whereas 40 per cent is the bank's traditional minimum of safety. The ratio had been 40⅛ per cent a week before, and 56 per cent at the same date a year before. No such showing of depleted gold reserve had been made by the bank since the panic of 1866.

Nor was this the end of the "currency panic," even for the period of English holidays. The

warning word that English paper money might possibly be no longer exchangeable for gold spread instantly throughout the community. People with gold coin in their tills or pockets refused to give it up, and within twenty-four hours Englishmen found it impossible to make purchases with Bank of England notes, if the amount of the purchase compelled the seller to make change. As the sense of unreasoning panic spread, householders began to accumulate and hoard provisions as well as gold.

On the Continent, for similar reasons, English bank-notes were refused when tendered in payment, and, what was much more disturbing, continental banks refused to cash letters of credit or bankers' drafts made payable at London. During nearly a week after the panic had begun, gold was the only available medium of exchange. For a time, indeed, even gold coin of another country was refused. When business closed for the day at the Bank of England on August 1, 1914, it is perfectly safe to say that no one, however experienced in the course of economic crises, knew what would be the financial case of England, or of Europe as a whole, when the next business day should begin.

CHAPTER III

EMERGENCY EXPEDIENTS

THERE were two traditional measures of protection for the Bank of England in such emergencies as I have just described. Both had been utilized in preceding London panics. The bank may advance its official rate for loans; an action which in ordinary times, by forcing up also the rate bid for money by the general London market, will cause a transfer of capital to London from other markets whose rate had remained unchanged, and, along with such transfer of capital, will start import of gold The governors of the bank may also, with the British Government's permission, suspend the Bank Act which requires the bank to issue no new notes, unless specifically secured by the same amount of gold on hand in the institution's vaults. The purpose of that action, as applied in the London panics of 1866 and 1857, is to provide currency wherewith to maintain or increase reserves of cash at the private English banks, without waiting for the Bank of England to accumulate gold.

As we shall see, neither expedient could adequately have met the situation of 1914. Yet the

bank applied the first expedient at once. On July 30 its official discount rate was 3 per cent; it was raised to 4 that day, to 8 on the 31st, and to 10 on the 1st of August. The 10 per cent rate was the highest ever fixed by the Bank of England; it had never been approximated since the great London money panic of 1866. At the same time the government authorized suspension of the Bank Act—a step taken since the act was passed in 1844 only on two occasions, in the panics of 1857 and 1866. The bank did not make use of the government's authorization in August, 1914, nor did it retain for more than a few days its 10 per cent discount rate. That rate was reduced on August 6 to 6 per cent, and on August 8 to 5—at which it remained during practically the whole of the two succeeding years.

It would probably not be unfair to say that both of these first incidents were in actual fact the result and symptom of panic on the part of bank and government themselves. It has, indeed, been quite invariably true of every sudden and grave financial crisis—notably of 1907 and 1893 and 1873 in the United States and of 1890 and 1866 at London—that unreasoning consternation got possession momentarily of the very people and institutions whose business it is to allay the panic of others. That this should have happened on August 1, 1914, when the financial crisis threaten-

ing London (all the circumstances considered) was undoubtedly the most formidable in the history of the world, and when, moreover, outright collapse of credit at London would have sent Great Britain into the war financially crippled in advance, was certainly no matter for surprise. But during Sunday, August 2, and Monday, a legal holiday, England's statesmen and financial leaders had a very useful breathing space in which to decide how really to meet the coming crisis.

The problem could not be solved on the lines of financial precedent, yet it had to be solved at once. It must be remembered that England had not yet declared war on Germany. The government and the great financiers undoubtedly knew, on August 1, that Germany was invading Belgium and that England would have to go to war. But the people at large did not know it. As a matter of fact, formal declaration of war was not made until Wednesday, August 5. Then was the time, according to all experience, to look for the crisis of financial panic. The stock exchange, traditionally responsive to such influences in advance of the rest of the community, had already suspended business, thereby confessing publicly that it could not face the shock. What was to happen next, and how were the consequences to be averted?

There were three portentous possibilities which, in the absence of protective measures of unprece-

dented character, were reasonable certainties The first was another run on the private banks for cash and on the Bank of England for gold—a run vastly more dangerous in its probable scope and consequences than the run of Friday and Saturday. The second was a sudden call by creditors for instant payment in cash of all sums due them on notes or bills or contracts; such demand being made at the moment when the banks were shaking, when money could not be raised by sale of securities on the stock exchange, and when, therefore, the demand for payment would mean bankruptcy of the debtors. These two possibilities had been familiar in previous financial panics, though perhaps never before in more alarming shape

But the third possibility was something with which no great financial market had ever been confronted since the modern credit system was established. To London—the banking centre of the world, the lender of capital to every other country, the market which provides credit facilities to all foreign markets to finance the world's international trade—the indebtedness of foreign markets when the war began was of stupendous magnitude. At first glance, this fact might seem to have been a strong point in the situation; and so it was rather generally considered by the community at large, before the war began and for a

very short time after its outbreak. But financial London soon learned better. It was one thing to have, on the books of London bankers, credits for hundreds of millions sterling in the shape of loans to foreign countries; it was a very different matter to collect them. If these foreign credits were in the form of stocks and bonds issued by borrowing companies or governments and held by London capitalists, the stock exchanges of the world were closed against the sale of them. If they were short-term loans granted to merchants by London for the purpose of conducting the outside world's immense international commerce—to pay the expense of production, manufacture, and transportation of the goods, with the two or three months' note of the purchaser turned over as security for repayment when the goods should have been sold to the actual consumer—no such indebtedness would be repaid by countries with whom England should be at war, and it was probable that, in the world-wide collapse of credit, it could not be paid by England's allies or by neutral countries.

Had the problem merely involved delay in collection by English bankers of what was owing to them—if nothing but their own capital had been at stake—the situation would have been awkward, perhaps embarrassing, but not necessarily critical. It would doubtless have necessitated

postponement of other business plans with the further result, in some instances, of pecuniary hardship. But the system of international banking was such as to put a far darker color on the consequences of non-payment by such foreign borrowers It was the proceeds of these short-term loans, as they matured from time to time, on which the London houses relied for payment of other short-term loans raised by themselves from banks or other banking-houses in Great Britain. The immense sums owed to Lombard Street bankers on current account by Germany and Austria, for example, were offset by almost or quite as large obligations of those bankers to home institutions. The machinery of finance was so arranged that these home obligations would be met, when they matured, through payment of simultaneously maturing indebtedness by the foreign markets.

But the instant that war was declared with Germany, payment of all such indebtedness to Lombard Street would end; yet the home obligations set against it would fall due as usual, and the credit of other English firms and institutions was staked on the payment of them. What was to be the consequence? It was easy on August 1, 1914, to imagine coming announcement of insolvency by the most powerful banking-houses in Great Britain. The condition of things which

had arisen explains why the German financiers and statesmen, then and during the progress of the war, reiterated in a triumphant manner the seeming paradox that one of Germany's most powerful advantages over England lay in the fact that the German market's loans to the outside world were so much smaller than those of London. There was a good deal of fallacy in the argument, Germany's own international finance was in a tangle, and the later financial chapters of the war were destined to prove the real value of England's position in regard to the outside commercial world. But the embarrassment of financial London at the start was very critical.

The protective measures taken by the banks and government in England were four in number All of them were unprecedented in the history of English finance Each of them amounted to confession that the existing credit system had broken down. None of them would have been considered, two or three weeks before, as a conceivable occurrence in London's financial history.

First, the government declared the two days following "bank holiday," Monday, August 3, to be special legal holidays; which meant that depositors could not draw money from the banks during that three-day period, and that payment of maturing notes and bills could not be required until Thursday. For London this was a startling

innovation. Its only precedent was the similar declaration of "special holidays," during our panic of 1907, by the legislatures of California, Nevada, and Oklahoma—an action taken to avert the threatened bank runs of the period, and discussed in Europe, at the time, as illustrating the primitive methods and impulsive action of our Western communities. But the London "special holidays" of August, 1914, were designed not only to prevent a run on the banks, or to give the financial community as a whole a chance to recover its wits. The three-day respite was instantly utilized for the second protective measure, preparation of an "emergency currency" to be issued under government auspices

This was something which had never been done before in English history. But a moment's reflection had convinced both statesmen and financiers that neither a 10 per cent Bank of England rate, nor permission for the bank to issue notes not "covered" with gold in the institution's vaults, would meet the situation. No bid for money could be high enough to draw gold from foreign markets whose own banks had already suspended gold payments. No additional issue of £5 notes, the lowest denomination permitted to the Bank of England, would prevent the drawing out of gold. We have seen how the people of England, during the three-day holiday, were

unable to make small payments with Bank of England notes. The "change" for such payments would have been gold, and gold was already being hoarded

What the treasury did, then, as the second of the protective expedients, was to issue, in denominations of 10 and 20 shillings, legal-tender paper currency These so-called "currency notes" were issued through the Bank of England to other banks, which pledged against the notes an equivalent amount of commercial paper, British Government securities, or credits with the Bank of England At the end of August, $125,500,000 of this new currency was in circulation; at the end of 1914, $192,300,000; at the end of 1915, $515,600,000; and it increased more than $134,000,000 in the next eight months.

As for the economic character and economic results of this remarkable experiment, for the present it need only be said that the hurried issue of this currency in the "war panic" ended the run on the banks, that it provided the requisite small money for the people, and that it apparently stopped the hoarding of gold. It is highly interesting to observe that these emergency paper issues, although an absolute innovation in English financial history, closely resembled in some respects our own old national bank currency secured by United States Government bonds, in

others the so-called "Aldrich-Vreeland emergency currency," authorized by our law of 1908 and based on securities and commercial assets. It was an irony of circumstance that English financial opinion had heartily disapproved of both of these American systems, each of which has in fact been now superseded by the new Federal Reserve system

The menace of a general "bank run" being thus averted, there arose the problem of dealing with a sudden and general demand of creditors for payment of money owing to them. When the Balkan War of 1912 broke out, the business communities of western Europe were interested and considerably annoyed by receiving, from the chambers of commerce in Bulgaria and Servia, formal announcement that, since all the business men were at the front and since their earning capacity was thereby interrupted, a "moratorium" on debts had therefore been proclaimed. The debts, whether owed to home or foreign creditors, were not repudiated; but, no matter when their payment properly fell due, they would not be paid until after the war. The great financial markets of the world looked upon that announcement much as it did on the news of the "special holidays" in our Western States in November, 1907. But in the one case as in the other, London had to follow in 1914 the example

of these other humble financial markets. This was the third expedient to meet the crisis.

On Thursday, August 6, a royal proclamation declared that all payments due on August 4, or falling due on September 4 under a contract drawn before August 4, "shall be deemed to be due and payable on a day one calendar month after the day on which the payment originally became due." This "moratorium" (the word now became familiar in European high finance) was expressly stated not to apply to wages and salaries, or to indebtedness below £5, or to rates and taxes, or to interest and dividends on securities, or to government payments, or to bank-notes, or to ocean freights, or to indebtedness due by individuals, firms, or institutions doing business outside the British Islands. With some alterations and amendments, the original proclamation was twice extended, carrying the date of the moratorium forward to November 4, 1914. By that time—and, indeed, in the case of most institutions by September—panic conditions had so far disappeared that business houses with maturing obligations relinquished the privileges of the proclamation voluntarily. Meantime, however, although the threatened chapter of bankruptcy was averted, the machinery of financial London, as of financial Europe generally and of financial America, came almost to a halt. When pay-

ment of indebtedness due to a business house is arbitrarily postponed by law, the creditor might protect himself by demanding similar postponement of what he owed to some one else. But such a condition of things would certainly not encourage him to embark on other business undertakings.

His eye would be fixed almost exclusively on the problem of disentangling himself from his embarrassing and humiliating position. It was instantly perceived that long continuance of that situation would very possibly cause paralysis to England's home trade and foreign commerce. Nor, indeed, was this the only danger. The moratorium, applying as it did to "all payments due on August 4," covered indebtedness of English firms to foreign creditors. It was a matter of far more serious concern to London's prestige as the money centre of the world that financial England should suspend payments to the foreign markets, than that payments of Englishmen to Englishmen should be deferred. We shall presently meet, in our narrative, some very tangible and very grave results of this international moratorium. As it stood it distinctly menaced London's economic position, and the next and fourth expedient adopted was directed to avert that imminent calamity. The problem was how to untie the hands of bankers and banking-houses who, un-

able to collect and use the huge sums owed to them in connection with their foreign business, could not stir. The moratorium had averted the immediate consequences, because the bankers were relieved from paying the equally great sums which they themselves owed at home. But this only shifted the burden to the shoulders of other houses; and moreover the moratorium, as we have seen, ran only for a month at first, and even its prolongations were known to be purely temporary. It could not be extended throughout the war; yet its final termination would leave these banking-houses with their home liabilities as pressing as on August 1, with the stock exchange still closed against sale of their securities and with their foreign assets equally beyond their reach. The result inevitably was that the great lending firms and institutions dared not increase their loans. They had their own position to fortify, and the market in which the drafts were discounted for the conducting of England's foreign trade began to shrink alarmingly.

It was then, on August 13, that a very bold and remarkable step was taken. The government announced that the Bank of England was prepared to take over from these international bankers all the "approved bills of exchange" for which they were liable on transactions prior to August 4. The bank would provide the funds

requisite to pay off these bills at maturity. The bankers would still remain ultimately responsible for payment, and that liability may cut a figure in London's financial history after the war Furthermore, to stimulate earlier repayment by the bankers, the rate of interest charged by the Bank of England for its services was to be 2 per cent above the official bank rate; and, although that official rate had been reduced from 10 per cent to 5, even that change left the rate for "rediscount" very heavy. But the Bank of England agreed not to claim repayment from the bankers for a period of one year after the close of the war, and the government of Great Britain "agreed to guarantee the Bank of England from any loss it may incur" in discounting such bills of exchange, "either home or foreign, bank or trade, accepted prior to August 4, 1914." The chancellor of the exchequer subsequently stated to Parliament that between $1,500,000,000 and $2,500,000,000 of such bills were believed to have been outstanding when the war began, and that of this total $600,000,000 had been taken over by the Bank of England. As was to be expected, this arrangement had some extraordinary results in the operations of the Bank of England. Wholly apart from advances made by the bank to the government, its loan account rose from $236,500,000 on July 30 to $609,100,000 as early as September 3.

On July 29, 1915, it reached its maximum of $960,900,000. From that time forward, chiefly because the "moratorium bills" were being so rapidly paid off from the accruing resources of the banking-houses, the Bank of England's huge loan account was gradually and progressively reduced. By the first week of June, 1916, it was down to the lowest total since the war began.

I have reviewed in this chapter the expedients by which financial London and the British Government met the crisis. Adopted as they were in the central money market of the world, where each and all of them were previously unheard-of innovations, and where each was a measure inconceivable to the financial mind a very few months before, this story of England's action in the war crisis sufficiently indicates the experience of the whole financial world. To set forth in equal detail the similar decrees and policies of the other belligerents and of the neutral countries would extend this narrative too far. No state other than England adopted the extraordinarily sweeping plan for assumption of bankers' non-collectible debts by the central banking institution. But almost every belligerent, and with them so financially powerful a neutral state as Holland, resorted in some way or another, temporarily or permanently, to an "emergency currency" Germany did not officially declare a

moratorium on debts, though the government intervened to render the action of the courts sufficiently lenient to achieve the same ends. France extended its moratorium even to rents, with inevitable after-complications.

Practically all of the moratoriums expired officially, early in 1915. But nothing could better illustrate the world-wide scope of the financial shock which came with the outbreak of the war, than the array of countries and markets which resorted to this postponement of payments through governmental decree. It was not only the European belligerents which had recourse to it. A formal moratorium was proclaimed at once in Denmark, in Italy, in Norway, in Egypt, in Greece, in Portugal, in Rumania, in Sweden (where it continued with certain limitations up to the autumn of 1915). Holland decreed special measures for extension of time to debtors. That Argentina, New Zealand, Paraguay, Nicaragua, Peru, and South Africa should have suspended such settlements from July, 1914, up to a date frequently fixed well into 1915, was a demonstration, partly, no doubt, of the enormous shock precipitated by the London panic, but chiefly of the extent to which the European War itself had deranged the entire economic system of the world.

CHAPTER IV

FINANCING THE WAR

EMERGING from the financial, commercial, and industrial panic of August, 1914, belligerent Europe was confronted with the problem of meeting the war expenditure. Into the complete and very intricate details of the fiscal operations involved in this stupendous task I shall not undertake to go But the immediate and the later achievements are of special economic interest from their conclusive demonstration of the extent to which the world's resources of available capital were underrated when this war began, as indeed they have been on every similar occasion in modern history. The nature of the task which at once confronted public exchequers in the fighting states may be judged from the fact that, whereas the British Government's average daily expenditure for all purposes, in the official twelvemonth ending March 31, 1914, was $2,750,000, daily expenditure for war alone reached $10,000,000 even in August, 1914, and averaged $25,000,000 before the second year of war was ended A year after the outbreak of the war the German finance minister, when announcing

in the Reichstag the third imperial war loan, stated that the daily cost of war to all the fighting Powers had risen to $75,000,000; the monthly cost to more than $2,000,000,000; the yearly cost to something like $25,000,000,000. The speech containing those estimates was made, moreover, before Bulgaria had entered the war and before the Balkan campaign of 1915 had begun.

Germany alone, this ministerial speech proceeded, was now spending in a single month more by one-third than the total cost of her Franco-Prussian War. At the daily rate of war expenditure then prevailing, it was possible to say that England would have paid out, within six months, more than the United States Government spent for military and naval purposes in all the four years of the American Civil War. It is commonly estimated that the war with France in the Napoleonic period, from 1793 to 1815 inclusive, cost England in the aggregate $4,150,000,000. But the chancellor of the exchequer declared to Parliament at the end of 1915 that England's expenditure, during only the twelvemonth period ending with the ensuing March, would amount to $7,950,000,000; and the average daily rate of outlay was progressively increasing.

These figures of the actual waste of capital in war were so large that to most minds they were merely bewildering. Some of the most experi-

enced international bankers ventured the positive prediction, at the beginning of this year, that the belligerent governments would not be able to continue raising the necessary funds after 1915. This prediction, like so many others made in the earlier months of war, received a sufficient answer from the progress of events. But the problem was of the highest economic as well as political influence, exactly how the various belligerent governments managed to raise these wholly unprecedented sums of money. In 1907, explaining the strain on credit and resources which had caused the world-wide economic crisis of that year, an eminent French statistician had estimated that the whole civilized world could provide annually for investment in new securities only \$2,400,000,000, or less than one-tenth of what the belligerent states, according to the German minister's estimate, were actually spending on war alone in 1915.

A few days after war had begun, the British Parliament voted to the government a preliminary war credit of \$500,000,000; the German Reichstag authorized an expenditure of \$1,250,000,000; the other belligerents granted similar powers to their governments. These votes were merely a formality; they left to the several finance ministers the practical task of obtaining the stupendous sums. By the middle of 1916, the

Parliamentary votes of credit had amounted to \$14,000,000,000, and the German, French, and Russian appropriations kept step with them. The resources of the great state banks were necessarily drawn upon at the start in the shape of huge advances of credit to the government. England began by placing with London bankers, every week or fortnight, the temporary obligations known in Lombard Street as "treasury bills." They had only six months to run, were issued in lots of \$90,000,000, and carried very low rates of interest; but recourse to long-term funded loans soon became unavoidable. Until 1914, the largest single loan ever issued by the British Government was the \$300,000,000 Boer War loan of 1901. In November of that year Great Britain offered to subscribers, payable in fixed instalments during the next five months, a thirteen-year funded loan of \$1,750,000,000, sold at 95 and bearing 3½ per cent interest, as against the 2½ per cent rate on the outstanding British Government bonds—which, however, were then quoted on the market below 69. The next loan, that of July, 1915, was for \$2,900,000,000 in 4½ per cents.

Germany came earlier into the market for long-term bonds, offering to investors a ten-year 5 per cent loan at 97½, for which \$824,000,000 was subscribed; she borrowed \$2,100,000,000 more the next February, and \$2,800,000,000 in the following

September. France relied longer on the national bank, which advanced $580,000,000 to the government for initial war expenses and $1,200,000,000 in all during the first six months of war, issuing note circulation against the government obligations deposited in its vaults, with results of which I shall have something to say later on. But the French treasury also sold to the public, at varying rates, the 5 per cent "national defense bonds" with short maturities, which reached $1,500,000,000 before 1916, having by that time been supplemented by a $2,762,000,000 sixteen-year 5 per cent loan, placed with investors late in 1915, at the low rate of 88

In addition to the outlay by the belligerent states for their own war expenses, the powerful belligerents made advances of money to their financially weaker allies in sums which would alone have served to finance the whole of a great war a generation ago. The British finance minister has shown that England, during the two first years of war, had loaned upward of $3,000,000,000 to its allies and colonies. France, in the face of her own economic troubles, has authorized advances of nearly $800,000,000 to such allies as Belgium and Servia. At the beginning of 1916 it was possible to state that the national debt of England, as compared with its debt when war began, had risen from $3,500,000,000 to

$11,155,000,000; of Germany, from $5,200,000,000 to $11,613,000,000; of France, from $6,600,000,000 to $13,197,000,000, and of Russia, from $4,500,000,000 to $8,655,000,000 This indebtedness had considerably more than doubled in a year and a half, the increase being the prodigious sum of $24,820,000,000 for only four of the twelve belligerents.

How was it possible for the people or the banks to provide such unheard-of sums? The first answer is the answer which the financial history of all great wars has given—that the actual resources of available capital, in a prosperous modern state, are always underestimated. An interesting calculation, by an international banker, is that the whole debt of England at the beginning of 1916 was only equal to one year's total income of the English people, and that whereas the increase in the debt, as compared with that at the end of the Napoleonic wars, was 145 per cent, the estimated annual income of the people had increased more than 800 per cent. Such estimates are not easily susceptible of absolute proof; but they show at least what factors are really operating in the problem. Capital, after all, is the whole world's accumulated wealth and property; the real problem of borrowing governments is how to get in touch with it.

Almost the first step taken, by all the Powers

confronted with these enormous requisitions for the war, was to stop the subscribing of home investment capital to other new securities. The English market had in a single twelvemonth, during the decade preceding 1914, invested as much as $1,337,000,000 in all sorts of new securities, home and foreign, and that was its highest record. In the whole of 1915 its total subscriptions to new securities footed up $3,426,000,000, but only $76,000,000 of that enormous sum was placed in ordinary investment enterprises. The $3,350,000,000 balance was entirely made up of British war loans, or of loans for war purposes, made to England's allies and colonies. At Berlin and Paris the story was the same.

This concentration almost exclusively on home war loans, of the accruing capital heretofore annually invested in other securities, provided part of the capital needed for the war loans, but by no means all. The war loans actually placed at home by England in the first twelve months of war finance, amounting to $4,750,000,000, were at least twice as large as the largest sum ever previously invested by the English market, during a corresponding period, in all new securities combined. Germany's $6,100,000,000 war loans were probably five or six times as large as her best previous record in absorbing new securities. From what source, then, were the remaining cash

subscriptions drawn? Some of them represented proceeds of foreign investments (such as American securities) sold back to the countries of their origin. A very large contribution came from deposit-banks, savings-banks, and all kinds of fiduciary institutions, which used their resources to the utmost limit in taking the new war bonds into their assets.

Much of the money must have come from use for loan subscriptions, by merchants and manufacturers, of business profits which they would usually reinvest in their own enterprises. Part came undoubtedly from drawing down closely the idle balances of bank depositors, part (and in Germany a very substantial part) through huge subscriptions virtually forced by government from lucrative war-munition enterprises like the Krupps. "No new enterprises are planned," a Vienna financial correspondent wrote in 1915, discussing the successful war loans of Germany and Austria. "No journeys are undertaken. Nobody builds himself a house or lays out a park."

All of the money once devoted to such purposes went, under the new conditions, to the war-loan subscriptions. Only a little reflection will be needed to convince the average man of the prodigious available fund which all these sources combined, if simultaneously drawn upon in a rich and thrifty country and under patriotic impulses

would provide for the public loans "Every citizen," one of the highest officers of the British treasury declared to the House of Commons, in a debate on the finances a month ago, "ought to be prepared to put at least one-half of his current income at the disposal of the state"

He might do this through subscribing to a loan, or through paying higher taxes; as to which last-named recourse I shall presently have a word to say. But no one, at all familiar with a thrifty community's rate of private income and expenditure, should need much argument to convince him of how enormous a war fund would be provided by such a process. It was after an American secretary of the treasury, in 1863, had found that sufficient war loans "could not be disposed of to capitalists without serious loss," that Jay Cooke and his army of canvassers, peddling the 6 per cents on commission, like book agents, from village to village, placed nearly $400,000,000 with the people at large. Instances such as this are perhaps the simplest answer to the familiar prophecy of the "economic ruin of Europe."

A Europe with greatly depleted capital and greatly diminished financial power, after the war is over, is a natural supposition. But that belligerent Europe is to be "economically ruined," in the sense that it will forever lose its old-time power in production, consumption, home and

foreign trade, and accumulation of wealth, is an absurd supposition. The world is dealing, in this episode, with an aggregate reserve of capital which is at least as much greater than that of the Napoleonic period, for instance, as the burden of war expenditure and war indebtedness is greater than what it was in the decade ending with 1815. Economic progress throughout Europe will unquestionably be arrested, probably for many years; with what accompanying phenomena, it is not easy to foreshadow; and any forecast of economic conditions in any or all of the belligerent states, when the war is over and the long process of financial readjustment begins, must depend in large measure on the duration of the war itself. If the theory were correct which was at first so widely held, that Europe in general or Germany in particular would break down economically under the strain of military expenditure, it would have been possible to imagine one or more of the belligerent countries reduced to a state of collapse, even before the progress of the military campaign had brought the conflict to any decisive conclusion.

Economic exhaustion, however, is a formula considerably more difficult to reduce to terms of concrete phenomena even than the other familiar theory of "government bankruptcy." One would expect to define the nature of such a process by

reference to the precedent of other wars. But military history throws little or no light on the question. If the other great wars of modern times prove anything in this regard, it would seem to be that belligerent states are not beaten purely by economic exhaustion It is apparently the teaching of such history that governments can fight on, often against seemingly overwhelming military odds, long after the puzzle has become inscrutable, where they could raise the money to carry on the war, how they could maintain their home and foreign credit, and by what means they could continue to feed both their non-combatant population and their armies. It has been unfailingly characteristic of all great wars, especially when they were prolonged beyond previous expectation, that even financial experts have predicted financial exhaustion, probably during the war, but in any case after it, as an inevitable consequence.

Macaulay has a passage much in point, on the public debt of England. At the end of the war with Louis XIV, that debt, he said, was considered, even by competent thinkers, "as an encumbrance that would permanently cripple the body politic." Nevertheless, "trade flourished, wealth increased, the nation became richer and richer." The prediction was repeated, with the same result, during England's other wars of the

eighteenth century. Hume argued, after the wars of the elder Pitt, that "all the revenues north of the Trent and west of Reading were mortgaged"; Adam Smith warned England against repeating the hazardous experiment. Yet the public debt, which was then £140,000,000, rose to £240,000,000 at the end of the American War, and to £800,000,000 at the end of the conflict with Napoleon. Had an enlightened man of 1792 been told, Macaulay continues, that "in 1815 the interest on £800,000,000 would be duly paid to the day at the bank, he would have been as hard of belief as if he had been told that the government would be in possession of the lamp of Aladdin or the purse of Fortunatus." But the subsequent economic history of England we all know.

Macaulay was writing primarily concerning after effects. But predictions have also been made early in such conflicts, and seemingly on the basis of sound reasoning, to the effect that financial expenditure on the scale required could not possibly last beyond a stated period. This was freely predicted regarding Japan in 1904, and not alone by pro-Russian financial prophets. The country was too poor to keep up such war expenditure; it had no adequate reserve of accumulated capital at home; the time must come when its government would no longer be able to raise funds abroad. The Manchurian war was cut short after a year and a half of fighting, through America's medi-

ation, and therefore it may doubtless still be argued on general principles that another year or two would have given Japan her financial *coup de grâce*. But the evidence which we do possess is embodied in the facts that Japan kept on raising public war loans at home, chiefly through popular subscription, and that her series of foreign loans were placed at London and at New York on progressively more favorable terms, after the first six months of warfare.

What even the London banking community, in the disastrous days of 1797, predicted regarding England's power to finance a continued war, did not greatly differ from what the New York banking community predicted regarding the United States in 1861, when the government at Washington found difficulty in placing a loan for a few millions with Wall Street bankers at 7 per cent. Yet England fought for the seventeen subsequent years, and raised something like $2,000,000,000 on its loans to pay the cost of it, while the United States raised and spent $3,000,000,000 purely for military and naval operations during the four years after Bull Run. The unsuspected sources of taxation discovered in these historic instances, and the unimagined reserves of private capital, reached by ingenious appeals from the government, might properly make the financial prophet cautious during the present war.

The same considerations, and others with them,

have bearing on another popular theory as to this huge economic burden This takes the form of prediction that belligerent Europe will "repudiate" its war debt—a word understood in various ways by the various people who use it. But nothing is more improbable than refusal of any great European government after the war to pay interest on that debt or the principal at maturity. The reason is that the present belligerents must borrow heavily, even after the war, to meet the continuing public deficit, and that a policy of bad faith in relation to the war loans would at once destroy the public credit. The erratic President Andrew Johnson, in his annual message of 1868 to Congress, described it as "just and equitable that the 6 per cent interest now paid by the government should be applied to reduction of the principal," because "holders of our securities have already received upon their bonds a larger amount than their original investment, measured by a gold standard." The overwhelming indignation with which Congress instantly voted down this fantastic proposal showed that they not only clearly recognized the moral character of such action, but foresaw its financial consequences.

Our legislators of that day voted down also the more insidious proposal to pay interest and principal on the war debt, not in gold, but in de-

preciated paper money. It is a striking fact, illustrative of the conditions possibly foreshadowed for financial Europe after peace, that on the continental money markets discussion has been heard of the plan to pay in paper money the interest on war loans, so far as the bonds are held by the people of those countries. But nobody has suggested payment of anything but gold for interest due to foreign creditors. Europe is well aware how far it must rely, after the war, on good financial relations with such powerful neutral communities as the United States.

Some interesting light has been thrown on this aspect of the question by another series of incidents in the financing of the war. I have thus far spoken only of the recourse to public loans to meet the war expenditure. Six months after the beginning of the war, Doctor Karl Helfferich, imperial finance minister, formally announced to the German Reichstag that the Empire would make no attempt to meet the cost of war through new taxes. "We do not," he declared, "desire to increase by taxation the heavy burden which war casts on our people." This was enunciating a principle practically new in the history of protracted modern wars. It amounted to asserting that the economic interest of a belligerent state would be served by meeting the whole war expenditure through public loans, thereby shifting the

entire fiscal burden upon the shoulders of future generations.

Doctor Helfferich, being an experienced banker and economist, was undoubtedly aware of the dangerous doctrine to which he was committing the German Government Therefore, in a subsequent speech to the Reichstag during August, 1915, he explained that "we owe it to the future of our people" that "the future development of their lives shall be freed from the appalling burden caused by the war." How was this apparently inconsistent end to be achieved? Through the fact, so announced the finance minister, that "those who provoked the war, and not we, deserve to drag through the centuries to come the leaden weight of these thousands of millions." In this remark were embodied two strong prepossessions of the German mind in the earlier months of war—first, that England, France, and Russia "provoked" the war which Austria made imminent by her insolent demands on Servia, the averting of which was blocked by refusal of official Berlin to join in England's proposals for mediation, and which Germany precipitated by her high-handed ultimatums and her unlawful invasion of Belgium; second, that Germany, having won the fight, would impose on her antagonists a cash indemnity running upward of $10,000,000,000.

Evidently conscious of the absurdity underlying these calm assumptions—especially with the enemy in possession of Germany's colonies, with England controlling the sea, and with the whole civilized world outside of Germany in agreement that reparation to Belgium was the *sine quâ non* of the final reckoning—the minister added, in a rather obvious anticlimax, that "the dreadful financial exhaustion of our opponents may seem to make this difficult of attainment." But at all events, so far as concerned the plan of paying for war exclusively by borrowing, "the force of circumstances has made England do the same." A slight increase in the English income tax and excise duties during 1914 "covered only 5 per cent of the English war bill." A subsequent attempt to increase the British income tax had "roused such lively opposition that its success is more than dubious." Therefore, with Germany, as with the other belligerent Powers, "the only method seems to be to leave the settlement of the war bill to the conclusion of peace and to the period after peace has been concluded."

But the German Government was presently to learn that it had misjudged the temper of England actually at war and confronted with rising taxes, as completely as it had misjudged the temper of England on the verge of war and confronted with Irish insurrection. When the first

"war budget" of 1914 had, as the German finance minister asserted, introduced only slight changes in the tax bill, the British taxpayers themselves insisted that their own immediate burden be increased In September, 1915, the new chancellor of the exchequer announced a very extraordinary series of new imposts. The income tax, already exceptionally high before the war began (owing to the government's extensive plans for social and industrial betterment), was raised nearly one-half beyond its previous figure. The tax on moderate incomes from investments rose to 17½ per cent of the income—a wholly unprecedented height, and nearly three times what it had been before the war—with a graduated "super-tax" on large incomes which raised the total exaction from incomes of $500,000 or over to no less than 34 per cent. Excise or import taxes ranging from 30 to 100 per cent were imposed on a number of articles in constant use. Rates for postage, telephone, and telegraph messages were heavily increased. Out of all profits from manufacture of war material, the government was to take one-half in taxes. Roughly speaking, the total annual revenue from taxation, which was $800,000,000 in the twelvemonth before the war began, was estimated now at very nearly $1,500,000,000. The absolutely new requisitions for the coming year footed up $510,700,000.

No such increase in a single season had ever been witnessed in the history of taxation.

Even so, only 24 per cent of the annual British war expenditure was being paid from taxes, whereas the common estimate of history had been that 40 per cent of England's costs in the Napoleonic War had been thus met. Early in 1916, however, another and even more startling budget of new taxation was presented to Parliament by the exchequer. The income tax went higher still; incomes of $10,000 a year, for instance, paying 25 per cent to the government. Other taxation then imposed brought the sum total of annual revenue of all descriptions up to $2,500,000,000, as against $1,130,000,000 in the twelvemonth ending with March, 1915, and $990,000,000 for the similar period ending with March, 1914. The percentage of increase was not so great as the rise in the United States Government's revenue from $41,400,000 in 1861 to $322,000,000 in 1865; but our Federal taxation when the Civil War began was negligible, whereas England's national tax revenue in the year before the war was the largest of any nation in the world. It was now possible for the British ministry to say that something like 27 per cent of the annual war expenditure was being paid from taxes, and that new revenue from that source was already providing in full for interest on the debt and a future sinking fund,

whereas Germany was paying interest on its later war loans with the proceeds of the earlier ones.

It should be remarked that this notable achievement was the achievement of England only. France made little or no attempt to meet the cost of war from taxes. Russia had decreased rather than increased public revenue through her embargo on the state-controlled sale of spirits. But the English budget and the remarkable unanimity of approval with which the taxpayers received it threw at least considerable light on the theory of "financial exhaustion." Even as regards the policy of Germany (which responded to England's new announcements by a not very significant new taxation yielding $120,000,000 per annum), it is fair to keep in mind that in 1913, when increasing her standing army, presumably in preparation for the war of 1914, the Empire had imposed what is usually the last word in taxation—a heavy percentage tax on property of every sort, to be paid in three instalments as a "contribution to imperial defense."

In view of what England actually did, it may safely be assumed that the power to raise money for the war by other means than loans had by no means approached exhaustion. Indeed, a very striking fact of the European situation was that the very familiar recourse of former wars—the

issue of paper money directly by the government and the use of it to meet the government's expenses, was practically rejected by all of the belligerents. The expedient of "government notes" not redeemable in coin was employed on an extensive scale in our Civil War; the economic meaning of them is that the government pays its current bills with its own promises to pay at an indefinite future date, forcing its creditors at home to accept such promissory notes as money.

Under this contrivance a government may at least appropriate the services and property of its citizens, as bankrupt revolutionary France did after 1789, without the necessity of procuring actual money for the purpose. The incidental and very formidable evils arising from such inflation of the currency with irredeemable and unsecured paper are well known. Prices of commodities rise to heights entirely out of touch with those of the world at large, and in the end the currency thus created may become virtually worthless on the markets, like the assignats of France, the continental currency of our own Revolutionary War, and the paper money of the Confederate States. These very familiar considerations easily explain why the European belligerents of this war should not have employed the recourse. But the fact, nevertheless, remains that the recourse might have been employed and

that it would have served to carry on the war. Therefore the absence of attempts to revive the old experiment of fiat money proved at least that economic exhaustion was not yet at hand.

CHAPTER V

FINANCIAL AMERICA AND THE WAR

OF all the surprises which have marked the financial history of the war, none was more complete than what happened with the United States. After twelve months, in which, with increasing rapidity, the world had become politically and financially disorganized by the epoch-making conflict, this country unmistakably reached, in its relations with all other countries, a pinnacle of economic power and prestige never previously attained by it, and never imagined, in the form it actually assumed, until long after the outbreak of the war.

The historian of the future will probably say that this was the quite inevitable result of the war itself. The six greatest European nations, including all of this country's richest and most aggressive commercial rivals, were engaged in wasting their own resources and crippling the resources of one another. In one European country of high financial rank, the banks had been seized by the invading enemy and their resources virtually confiscated. From Paris $900,000,000 gold and

silver, the reserve of the Bank of France, had been hurriedly removed to a distant port to escape impending capture. Bombs were dropped from air-ships in the neighborhood of the Bank of England Berlin was cut off, commercially and financially, from the rest of the financial world. What result more natural, under such circumstances, than that money of foreign countries, seeking a surely guarded resting-place, should pour into the banking institutions of the greatest neutral state? What other outcome was to be expected than that the foreign trade of this powerful neutral nation should expand to previously unimagined proportions?

Such, indeed, is to-day admitted by the whole financial world—now that we know what actually happened—to have been the inevitable logic of the situation. Yet there were several highly important contributory causes which could hardly have been predicted in advance, and which certainly were not predicted. Furthermore, this sudden rise to overshadowing economic power and prestige is precisely what the high financial experts, at the beginning of the war, had declared could not possibly happen. The United States was believed to be in great measure economically dependent on Europe. Two years before, it had been declared on well-known banking authority that even in normal times our annual dues to

Europe—for interest and dividends on American securities held by foreign investors, for payment of freights on foreign ships, and for remittances covering expenditure by Americans living or travelling abroad—were so enormous as to exceed by more than \$500,000,000 our normal excess of merchandise exports over imports. The difference had to be met through Europe's investment of capital in this country. Europe, the inference proceeded, could if it chose, even in an ordinary year, have called for payment of this \$500,000,000 debit balance in gold. Probably the estimate much exaggerated the actual situation. Still, it was based on facts which did exist.

It is true that, during one remarkable episode of our financial history, fifteen years before this war, New York had indulged for a few months in the dream of becoming shortly the independent financial centre of the world—"displacing London" was at the time the favorite way of putting it. The course of events which led to that premature expectation provides a curious parallel of circumstance (though on a far smaller scale of operation) with that of 1915. England, in 1901, had been for a year at war with the Transvaal Republic. London's financial markets were gravely disturbed; even that little conflict was costing the British exchequer a million dollars per day. The United States, in the half-dozen years after the

panic of 1893, had been economizing and saving; it had put its currency in order and had established the gold standard beyond dispute. It had raised the two largest grain crops in its history at the very time when Europe's harvests failed; had thereby increased its exports to a figure in those days utterly amazing, and had witnessed such financial and industrial prosperity at home as promised unbounded possibilities. When, under all these circumstances, continental Europe began to clamor at the capture of its markets by our manufacturers, and when this was followed by the subscription of our bankers to $208,000,000 of the British war loans—the first ever sold by the exchequer to foreign subscribers—it was not strange that prediction of New York's coming supremacy in the financial world should have been the watchword.

Reviewing that episode, after the later incidents in our economic history during the European War, there is much in the nature of economic coincidence. But whatever, in the longer sequel, is to be the outcome of our country's rise to international power after 1914, the predictions of 1901 turned out very soon to be illusions. A few exciting months, and our own most ambitious financiers admitted reluctantly that at the height of our economic prestige we had really been using European capital, which came to New York of its own accord, because of America's temporarily

great prosperity. Long before 1907, Wall Street was once more openly borrowing by the hundreds of millions, and in every European money market.

France and England had to help us out of that year's financial pitfalls. In the ensuing half-dozen years our financial markets continued to draw on Europe's capital, at a rate which suggested that such help was an immediate necessity. The spectacular incident in our markets of 1909 was the effort to induce the Paris Bourse to take over part of the capital stock of our largest joint-stock company, the United States Steel Corporation. In 1910 our most powerful railways sold to the Paris market more than $50,000,000 of new securities Between that year and 1914 the reluctance of Europe to support our markets (for reasons of its own, already explained) caused great financial depression in this country. Even a borrower in such high credit as the city of New York, hesitating to press new bond issues on the American market, placed no less than $100,000,000 of its short-term obligations with European bankers, and had to pay a high interest rate to get them placed. We shall hear of these New York City obligations again in the course of our present narrative; the great bulk of them happened, unluckily, to fall due in the autumn of 1914.

Such was the position which, at the outbreak of

the war, American finance seemed to occupy with relation to Europe. It was surely no matter for astonishment—even when the logic of the situation might have been plainly reasoned out on the lines suggested at the opening of this chapter—that the gloomiest forecasts of all, regarding the American outlook, should have come from conservative and experienced financiers. The most that even Wall Street ventured to predict of a hopeful nature, in the first two or three months of the European War, was that American exporters might capture the South American and Asiatic markets lost by Europe. The most that financial London had to say, by way of encouragement, was that when the war should end the United States might be brought, through its previous neutrality, to a position of high financial power. It must now be our task to answer the question, why every one of these high experts was wrong in his prediction, to see just what actually happened, and to determine why it happened.

What happened first was of a character to confirm the most unfavorable judgment. The New York Stock Exchange closed its doors on Friday, July 31, the day of London's closing. There was strong opposition to such action, on the stock exchange itself, but it was silenced by evidence, presented to the officers of the exchange, that selling orders from Europe, already placed with

bankers and brokers for execution as soon as the exchange should open Friday morning, were of a magnitude and character such as to threaten the gravest consequences. Houses through which Europe's investing communities commonly made their purchases or sales on the New York Stock Exchange reported that every market in the world seemed to be making ready for the sale to New York at once of all the American securities that it could dispose of. It must be remembered that, with war now recognized as inevitable but with no protective financial measures yet adopted, there was a double motive for such sales at almost any sacrifice. First, not a banking-house in Europe was sure of its own continued solvency; therefore the instinct which always governs the financial mind in time of panic—to convert investments instantly into cash—operated with unprecedented violence in this greatest of all financial panics. But, second, the European banking community's knowledge of the prodigious coming demand for capital by the belligerent governments urged immediate preparation of the necessary free resources.

Closing of all the European exchanges had put a stop to liquidation on those markets. Had the New York Stock Exchange reopened on July 31, it would have been the only great market in the world available for such sales; and foreign in-

vestors held at the time, as subsequent expert investigation pretty clearly proved, hardly less than $4,000,000,000 of American securities. Of the great mass of foreign selling orders, awaiting execution at the New York opening of the 31st, a very large number explicitly provided for acceptance of bids as much as 15 or 20 per cent under the previous day's market. Some fixed no limit whatever on the price. When it is further stated that prices of such securities had already fallen 10 to 20 per cent in the few preceding days, and that the New York banks had loans outstanding in the hundreds of millions, based on pledge of these securities at their previous valuations, the reason why the board of governors closed the New York Stock Exchange is evident.

The fact that after the exchange had reopened, five months later, this European selling was resumed on an extensive scale, yet without seriously disturbing the course of prices, has occasionally raised the question whether New York might not safely have left its official market open after July 30, purchased the American securities thrown over by Europe, and thereby gained at once the international prestige which was actually achieved only after long delay. No one can absolutely prove a negative. Theoretically, at least, the thing might have been done. But it would unquestionably have been done at the cost of far-

reaching insolvency. The New York Stock Exchange at the end of July confronted world-wide panic. When it reopened in December, Europe as well as America had applied the necessary protective measures; panic, at least, was over. The foreign selling of our stocks and bonds during 1915 was orderly and deliberate, only as much was sold from day to day as the market would take without break in prices. The banks, as we shall presently see, were able then to facilitate the process. But the immediate course of events, after July 30, 1914, showed how ill-prepared they were for such service at the time Even supposing New York to have surmounted the "war panic" of midsummer, 1914, without shutting the doors of its stock exchange, the failures which must have followed could scarcely have been limited to Wall Street brokers. If deposit banks had also closed their doors in the frantic rush of stock-market liquidation, the shock would have reached the bank-depositing public and the domain of general industry.

It was, in fact, immediately evident that the crisis had by no means been averted by the closing of the stock exchange. Nobody knew what would be the next turn of international finance. Nobody knew whether panic would not break out among bank depositors. Whatever protection the closing of the stock exchange may have given in

other directions, the banks at any rate had lost through it the opportunity of selling their own securities, and thereby fortifying their cash resources. With the situation thus obscure and menacing, the banks of New York, followed by those in other American cities, promptly adopted two emergency expedients One had never been employed except in time of panic; the other had never previously been employed at all.

The first was the issue of what were called "clearing-house loan certificates" This expedient (originally designed solely to enable one or more embarrassed banks to protect their own cash reserve) permitted such institutions to use interest-bearing due-bills instead of cash, when paying for checks drawn against them, deposited with other banks for collection, and presented for payment by such other banks. But the plan never worked within those limits. Since every bank in a given clearing-house had an equal right to "take out clearing-house certificates," and since every bank was confronted with a possible "run," the process soon came to mean that all the banks of a given city would suspend cash payments to one another. This in turn invariably caused suspension of cash payments to depositors, or at least restriction of their cash withdrawals to small sums. The consequence had been, in each of our greater panics, that employers

of labor could not draw from their bank-accounts the cash required to meet their weekly pay-rolls. In the panics of 1907 and 1893, currency was bought and sold on Wall Street at a premium as high as 4 per cent, the $104 asked by the brokers for $100 actual money being paid in certified bank checks During the panic of 1907, there were outstanding, in the various cities of the United States no less than $227,114,000 clearing-house loan certificates; they remained in use at New York during twenty-two successive weeks, and the "premium on currency" lasted two full months. In 1914, the maximum amount at any time outstanding was $195,754,000

The suspension of cash payments at the banks, and the currency premium at New York, would presumably have occurred again in August, 1914, but for the second and novel expedient adopted by the banks. Such conditions might, indeed, have lasted longer even than in 1907; for in that year the crisis was relieved by immediate import of almost $100,000,000 gold from Europe, whereas the five months after war broke out in 1914 were marked, as we shall see, by export of an exactly equal sum. Simultaneously, however, with the recourse to clearing-house loan certificates the so-called "Aldrich-Vreeland Law" of 1908 was put into operation

That law passed Congress a few months after

the panic of 1907, its purpose was to establish machinery for rapid increase of the currency in panic time, and thereby to avert such hoarding of money, drawn from bank reserves and other ordinary channels, as locked up from circulation, toward the end of 1907, no less than $296,000,000. A properly elastic currency-issue system, such as exists to-day, would have served the purpose; prospective money hoarders would have got nothing but new bank-notes. But long discussion and debate were necessary before a law with the requisite scope and detail could be framed, and the "emergency-currency law" of 1908 was enacted to bridge over the intervening period. The older law permitted national banks to issue notes only on pledge of United States bonds with the government; this was a slow and greatly restricted process. The "Aldrich-Vreeland Act" authorized instantaneous issue, within carefully prescribed limitations, of currency based on the pledge of other assets of the banks, such as approved notes of mercantile borrowers. In the six years up to August, 1914, no bank had applied for such "emergency currency"; but the notes were engraved, held by the government, and kept ready for immediate delivery. They were put out without delay in 1914. By the 3d of August $46,000,000 of them were in the hands of New York banks. Depositors who asked for cash were

paid in this new currency (which in form was hardly distinguishable from the old-time bank-notes), and the banks retained the gold and legal-tender currency in their reserves

This machinery, then, provided without any fresh legislation that immediate relief which Europe obtained only through new and hastily contrived expedients. It is a highly interesting fact that English bankers were at work on plans for a similar special currency at the very moment when the war broke out. It was to have provided for additional note issues in time of stress, secured one-third by gold and two-thirds by negotiable securities. The private London banks and the British Government had favored it, the Bank of England opposed it. "The bankers," one of the committee subsequently wrote, when describing the August bank panic at London, "understood that the opposition either was or would be withdrawn, but it was too late." The alternative plan of "currency notes" had to be adopted.

The results of the application in this country, of the statute of 1908, were most important. But so violent was the shock of panic that they were slow in operation. In the three weeks between the end of July and the middle of August, 1914, actual money in the reserves of New York banks decreased $83,000,000; nearly all of the decrease being gold. Under the old national bank law

then in force, city banks were required to keep on hand in "lawful money" (a technical term which did not apply to the new "Aldrich-Vreeland notes") 25 per cent of the amount of their deposits. On July 25 they held $25,127,000 more than that requirement; on August 15 the actual deficit below the 25 per cent was $47,992,000. Nevertheless, it soon appeared that no inducement for continued hoarding existed any longer, when banks were freely providing customers with the currency issued under the law of 1908.

So much had been accomplished; yet after all it had only served to check one symptom of the panic. There was little in the situation, during the three or four months which immediately followed the outbreak of the war, to foreshadow any other favorable change. It was during those few months that prediction as to the influence of the European War on this country's economic position was most hopeless. Between July and November, 1914, the outlook for American prosperity seemed, even to trained and practical financial observers, to be altogether dark.

There was abundant reason for misgiving. Quite apart from the disturbing possibility that Europe would call for instant repayment of the enormous sum of capital invested in the United States—an achievement as impossible for our market as a bank's immediate payment in cash of all

the deposits on its books—the entire framework of finance, commerce, and industry had been shattered by this mighty blow. During the first few weeks of war, the country's maritime export trade came almost to a halt; ships with cargoes already on board were afraid to risk the chance of seizure by cruisers of the belligerent powers. When England had chased the hostile cruisers from the sea and the ocean highway was reopened, our lucrative trade with Germany had disappeared. In the five last months of 1913 we had exported $186,000,000 worth of merchandise to that country. In the same five months of 1914 we shipped only $2,200,000. This country's total export trade in August decreased $77,000,000 from the year preceding, for September and October combined, the decrease was $138,000,000. This was no favorable omen for the payment of our accruing foreign dues, as usual, in merchandise.

Not only, in fact, were shipping facilities suddenly and heavily reduced, but the shock to international credit had instantly impaired the buying power of neutral countries, while the question what belligerent Europe could purchase from America was entirely obscure. It is true that the wheat market is traditionally stimulated by war, and that the wheat crop just reaching harvest in the United States, when war began, was the largest which we had ever harvested. In that branch of

export trade we shall encounter highly interesting developments later in our narrative. But the cotton-growing industry, though that crop also produced in 1914 the second largest harvest of our history, found itself for that very reason in a dangerous predicament.

More than half of our yearly crop of cotton is sold and shipped to Europe, the value of that export having risen as high as $600,000,000. But Germany was our cotton trade's second largest foreign customer; her market was cut off, while the textile industry in the rest of Europe, along with other manufacturing activities, was paralyzed by the shock of war. In September, October, and November, normally the months of large shipments from the newly grown cotton crop, the country's cotton export footed up in 1914 less by $218,000,000 than in the corresponding months of the year before. The prospect seemed to be that possibly one-third of our crop of 1914 would be left on the planters' hands. Now the South not only depends on its sales of cotton for its income of the season, but it had spent large sums, often of borrowed money, for wages, rent, and materials. An outcry arose at once that the South was facing ruin. Excited congressmen proposed that the national treasury lend $500,000,000 to the planters; that currency be issued on the security of cotton; that the government guarantee a profit-

able price for cotton, which was then falling rapidly on the market. Efforts were made to start a nation-wide canvass for the purchase of a bale of cotton apiece by charitable citizens, and in the end a fund of $135,000,000 was conditionally pledged by banks throughout the country to lend against cotton and save the South from ruin.

As was shown by the event, this cotton-market panic was unreasonably exaggerated; the South shared fully in the country's later war-time prosperity. Still, it was one discouraging sign of the early autumn of 1914. While this was going on, our manufacturing industry was beginning to discover that many hitherto indispensable raw materials, such as dyestuffs and chemicals, were apparently cut off from access to our markets. Production slackened rapidly in the steel and cotton-spinning trades. Bank checks drawn in the whole United States during August decreased 19 per cent from the year before; in September and October the decrease was 25 per cent. This pointed to such shrinkage in actual business activities as had been familiar only in periods of severe depression.

With foreign trade and home industry thus deranged, there remained the question of our indebtedness to Europe. The protective measures already taken in the banking and currency situation dealt solely with the financial crisis at home.

The closing of the stock exchange merely protected us, temporarily, from Europe's sales of American securities. Neither guarded against the sudden and urgent recall of capital in other forms. Our markets were heavily in debt to Europe, not only through American stocks and bonds held by foreign investors but through loans coming to maturity almost daily. England, our largest creditor, was calling for instant payment, and we could not blame her for it Her own necessities were urgent. Loans due to her from the European Continent were non-collectible because of the war; loans due from nearly all other neutral countries were non-collectible because of the moratoriums. There was no war and no moratorium at New York, and London called on the New York market to pay what it owed.

It seemed inconceivable that New York could meet the call. In the last week of July $42,000,000 gold was taken for export to Europe; no outgo on such a scale could continue very long without eventually exhausting the available gold reserve of both banks and government. New York's "par of exchange" with London is $4.86⅝, which means that an English gold sovereign is intrinsically worth that amount in American currency. The usual cost of freight and insurance, with the temporary loss of interest on the money, is such that the rate of exchange may rise, say to

$4.88½ or $4.89 in the pound sterling, before it will be profitable to send gold from New York to London. Ordinarily the rate can go no higher, since at that figure the gold may be obtained and shipped. But during the five last days of July, when financial London was falling into panic, New York exchange rose successively to $4.91½, to $4.95, to $5, to $5.50, and, finally, on August 4—the day of Great Britain's ultimatum to Germany—to $7 in the pound sterling.

No rate anywhere near to this had ever been reached in the history of the New York market. Since the rate of exchange thus touched was impossible with gold shipped freely to London, to pay the balance of international indebtedness against New York, and since $4.86⅝ to the pound sterling was the intrinsic parity of exchange, the $7 rate meant, theoretically, that the American currency was depreciated 43⅛ per cent on the foreign market. We shall encounter this measurement of currency depreciation again in the later chapters of the economic history of the war. Of this particular episode, it is enough to say that the depreciation was quite artificial, for two reasons. A treasure ship could not be trusted to make the passage from America to England; there was therefore no limit to the price in dollars which might have to be paid by a New York banker whose obligations in London were falling

due, for a draft redeemable at London in pounds sterling. But it was also an artificial depreciation because the treasury continued freely to redeem the American currency in gold.

But, on the other hand, it soon began to appear, even after the British fleet had driven Germany's ships from the sea, that the New York banks were not disposed to give up gold for export. The loss of the $42,000,000 gold for that purpose, at the end of July, had shaken the financial community's nerves. If, in response to London's calling in of its foreign credits, shipment of gold had continued at that weekly rate, the $308,900,000 gold in the vaults of New York's banks on August 15 would have been exhausted in less than two months. A run on the treasury reserve, to get gold in exchange for government legal-tender currency, would apparently have followed.

Furthermore, the New York bankers pointed to the fact that the moratorium on debts, proclaimed by the British Government, applied to indebtedness due by English bankers to American creditors. Why, therefore, should gold be sent to London to pay what New York bankers owed in that city? On the face of things, the American money market seemed to be on the verge of joining Europe in her confession of financial helplessness. New York had almost established, auto-

matically and without governmental sanction, a moratorium of its own on foreign obligations, and among those obligations were the short-term bonds of the city of New York, falling due and payable in Europe before the end of 1914.

CHAPTER VI

THE NEW YORK MARKET'S ACTION

THE decision which the New York banks were now compelled to make was of critical importance; but the true nature of the crisis was imperfectly understood. In the highest financial circles, opinion divided sharply. Should New York, under the plausible pretexts of the moratorium on London's own external debts and of the danger threatening this country's gold supply if we met the instant claims of foreign creditors, postpone payment of its own maturing foreign indebtedness? Or should such payment be made on the spot, regardless of consequences? There was much to say for either alternative Probably, during the first few weeks of war, the prevailing judgment, even among experienced bankers, favored the first-named policy. Much that is clear to-day, in the light of subsequent events, was altogether obscure in August, 1914. Ideas regarding both present and future were still colored deeply by the conviction that the basis of credit had been absolutely broken down; that the catastrophe involved in Europe's political

and economic crisis was imminent, world-wide, and unavoidable, that unless peremptory protective measures were adopted, reversion to primitive methods of international exchange would force every debtor country to the wall when creditor countries grasped at its resources. The United States was one of these debtor countries Why, then, did not its only rational policy lie in imitating belligerent Europe and suspending payment of international debts?

What would have been the outcome in the country's immediate economic future, if that policy had been adopted, it is somewhat difficult to say. We have evidence of what financial Europe thought. Writing when the actual decision was still hanging in the balance, a well-known London financial expert, later appointed special adviser to the British exchequer, declared that the existing crisis "was the chance of a century for New York." A neutral market which had promptly paid its own international bills in gold, and had granted credit to other hard-pressed debtor countries, "would have stepped straight onto London's financial throne and set London a very difficult task to regain it after the war was over." But America "feared to use its gold, and held on to it as tightly as it could, fearful of internal trouble and a run on its banks if too much of the metal went abroad." The result was "the

depreciation of the American dollar as compared with the pound sterling" "It was the chance of a century; but New York could not take it."

A month or two later, this London expert would hardly have thus described the policy of financial New York. Four months later, he might have been compelled to draw a different conclusion as to the possibility of New York's displacing London. But what the London critic obviously meant was that if the American market had surrendered, had followed the rest of the neutral world in suspending international payments, it would thereby have publicly proclaimed, at the very outset, its inability to stand alone, and would have joined the long list of banking and investing centres in whose custody foreign capital could not be placed with any certainty of getting it promptly back again when needed, or of recovering it at all, except at a rate of exchange which would not recover its original face value. We shall presently see what moral effect was produced on foreign depositors, both by the action of Great Britain in proclaiming a moratorium and by the action of the American community in rejecting any form of that expedient. For the policy of arbitrary debt suspension was rejected —not by edict, nor even by general consultation and consideration, but by bold and courageous grappling with the first concrete case.

It was fortunate that this case presented a clean-cut issue. At London, there were about to fall due £13,494,000 in notes of New York City; at Paris, 61,500,000 francs. Payment in gold at those cities, on the stipulated date, was nominated in the bond. Two or three New York bankers accepted this situation as the crucial test, and called on the banks of the city to provide for the payment. Their task was not easy. No one institution could provide single-handed the $80,000,000 gold required for export; if done at all, the work must be done by joint action of all the largest banking institutions So great was the hesitancy of responsible bank officials that the only argument which eventually broke down opposition in some important quarters was the blunt declaration that "if the credit of New York City goes by the board, all the rest might as well go with it."

But the credit of New York City did not go by the board. The New York banks subscribed to a new $100,000,000 bond issue of the city, each bank agreeing not only to pay the stipulated price for its allotments, but to provide, in the ratio of its individual subscription and in gold or in bills of exchange convertible into gold at London, its share of the $80,000,000 European obligation. With a view to avoiding the still-existent risks of ocean transit, the Bank of England established a

branch at the Canadian Government depository, Ottawa, agreeing to accept gold payments at that point as made in London. To that destination, something like $35,000,000 gold was exported from New York as the city's European loans came, one after another, to maturity.

As always happens in such circumstances, the smoothness with which this large transaction was completed paved the way for further concerted action on the problem of international payments. The "New York City loan pool" went into operation in the middle of September. By the close of the same month arrangements were under way, on a very much larger scale, for shipment of gold to meet the remaining balance of international indebtedness against us. This was a far less simple operation than the financing of New York City's debt. Since in this instance it was impossible to measure the full scope of the foreign claims beforehand, it would clearly have been imprudent to begin by trusting to unregulated export of gold, whose increasing magnitude might, in the prevalent uncertainty, have ended by throwing the subscribing bankers into panic

The course pursued, therefore, was the inviting of banks throughout the United States to subscribe (as nearly as possible in the ratio of their cash resources) the sum of $100,000,000 gold; from which fund the gold required for export,

in order to adjust the unfavorable balance of exchange, should be drawn and shipped to Ottawa for account of London. This remarkable operation was directed by a committee of bank officials with nation-wide reputations, who were to call up the subscriptions of gold pro rata, as fast as actual export needs developed. Beginning at the opening of October with an actual shipment of $10,000,000 to Ottawa, this undertaking made clear to all the world the meaning of the newly adopted attitude of American financiers.

Its moral effect on international opinion was very great. It is an axiom of banking that the way to stop a "run" is to give public and tangible evidence of readiness to pay. The bank depositor who rushes to the paying-teller's window, insisting that his balance be paid at once in cash, and who finds that official with a pile of gold or currency at his elbow, cheerfully handing out the cash to applicants, is extremely apt not alone to change his mind about withdrawing his deposit, but to pass along to the receiving-teller's window with a new deposit. That very human instinct, entirely familiar in the case of humble individuals, displays itself as invariably in the larger field of banking operations; with capitalists, communities, and nations. The action of the "bankers' pool" was closely watched, in Europe as in New York. When it was seen that $8,000,000 to $10,-

000,000 gold per week was quietly being drawn from the banks and shipped to Ottawa, exactly that result ensued which occurs when the paying-teller promptly meets all demands of bank depositors in a "run." In this larger instance of what had seemed to be a run by Europe on the gold reserve of the United States, the American bankers' systematic shipment of gold to the Bank of England's branch in Canada—the total gold export from this country between August 1 and December 31 being no less than $104,900,000—had the visible effect, first of reducing Europe's demands for immediate payment of our international indebtedness, then, in due course, of drawing capital from abroad to the United States Under these various influences New York exchange on London had returned, by the last week of October, 1914, to the rate of normal times.

But New York had not yet been disentangled from the complications in which the whole financial world had become involved when war began. American bank reserves and American currency were still under artificial influences. Clearing-house loan certificates were only gradually abandoned; new issues of the sort were made by New York banks as late as the middle of October, and at that same date the "Aldrich-Vreeland" bank-note issues, confessedly an emergency expedient, were almost at their maximum. What was possi-

bly even more to the point in its bearing on our international financial prestige, the New York Stock Exchange was still closed for business. Foreign capital, whether from belligerent or neutral markets, might doubtless now be deposited in American banks, with confidence that it would be returned on demand in gold. But conversion into cash of foreign capital invested in American stocks and bonds, or conversion of cash into such securities, continued to be impracticable. We are now to see in what way these three impediments—the emergency bank-reserve money, the emergency paper currency, and the emergency embargo on sales of stocks and bonds—were next to be removed

The clearing-house loan certificates disappeared automatically, as they have always done when panic has disappeared, hoarding of currency has ceased, and cash in the bank reserves has risen to normal proportions. Before the end of October, notwithstanding the large export of gold from New York since July, the sum total of gold and United States notes in New York bank reserves (which had at one time fallen $61,000,000 below the figure of August 1) was within two millions of the August figure, and the "surplus reserve" was restored, for the first time since that date; by November 28, all of the loan certificates that the New York banks had issued were re-

deemed and cancelled, by December 14, none of them was left outstanding in the United States.

The "emergency bank-notes" of the law of 1908—of which $384,500,000 were in circulation in the later autumn of 1914—were subject to a tax which increased gradually as time went on and the notes were not redeemed. The tax had not yet arrested the employment of this currency, for the banks were still surrendering gold for export, financial judgment as to what would happen next was doubtful and suspicious, and no one was disposed to give up so serviceable a safeguard against another shock to public confidence. But at the moment when the financial ship was beginning in many other ways to right itself, an achievement of the first importance settled the question of the currency It is fair to describe what happened as a remarkable coincidence—a windfall of the most timely and extraordinary good fortune to the United States.

Long before war in Europe had been discussed in America as a present possibility—as far back as the later months of 1913—the Wilson administration had devoted all its energies to effecting the passage of a proper currency and banking law I shall not attempt to describe the numerous and complex provisions of this statute, or to narrate the somewhat confused phases through which the act, very imperfect as originally framed, was

at last amended into shape insuring a scientific modern system. The essential aspects of the law which received the President's signature in December, 1913, were these: Instead of leaving every bank to use or misuse its own reserve of cash in a time of stress or panic, it established twelve central institutions in as many districts of the country, each "reserve bank" to hold in its own vaults the bulk of the cash reserves of banks within its district.

Thus held, the "gold and lawful money" could still be counted as part of the reserve of every "member bank." In return for such surrender of cash reserves, each central institution was bound to rediscount on request loans already carried by member banks; in other words, to lend to a member bank, at a fixed rate of interest and on security of the merchants' paper which was the basis of the member bank's own loan, the money originally advanced to mercantile borrowers by that member bank. This process meant that when requirements for credit on the part of their business clientage were greater than the individual banks could meet, in their existing position of reserves, part of the burden might be shifted to the reserve bank of the district. The loan or "rediscount," thus obtained by a member bank from its central institution, was to take the form of a credit balance in the reserve bank. That

credit balance the member bank might count as part of its own reserve; or the member bank, if it so desired, might draw on its balance, receiving the new currency known as Federal Reserve notes These notes, though not themselves available for bank reserves, were available for all the uses, in hand-to-hand money circulation, belonging to the national bank-notes which they were intended to replace.

The nature of the notes and bills rediscounted, and the term for which they were to run, were carefully prescribed in the statute; the total amount rediscounted for any member bank was not, under ordinary circumstances, to exceed one-half of its capital and surplus, and was never to exceed the whole of those two funds. Against all deposits credited to member banks, through rediscount of their loans or otherwise, the Federal Reserve Bank must maintain in its own vaults 35 per cent in specie or government notes. Against all note circulation issued by a Federal Reserve Bank to a member bank, and by it paid out to the public; the reserve bank must maintain a reserve of 40 per cent in gold. Finally, in order that the twelve reserve banks of the twelve allotted districts should be held to a harmonious general policy, and in order to insure their united action in a financial crisis, a so-called Federal Reserve Board of seven members—two of them

government officials and five named separately by the President of the United States—was created, with wide supervisory and restrictive powers over the entire system.

Such, in its general outlines, is the machinery of the banking and currency system enacted at the close of 1913. No one imagined, when the law was passed, that urgent necessity for beginning its operation was so near at hand. Its actual introduction was in fact accomplished rather slowly. It was three or four months before the prescribed committee had arranged the twelve districts and the location of the twelve reserve banks. Not until one week after the outbreak of the war was the Federal Reserve Board itself completed, and it was several months more before the new reserve banks were actually organized. At length, on November 16, the new banking and currency system went into force. Its inauguration was followed by retirement of the $384,500,000 emergency bank-note currency, which was taken up so rapidly, through issues of the new Federal Reserve notes, that before the middle of 1915 it had wholly ceased to exist.

It will not have escaped the reader's notice that the new banking system entered on the scene at what may be termed the exact psychological moment. New York had publicly resumed payment of its maturing foreign debts in gold. Foreign

exchange, whose rates had for three months run so abnormally against New York, was back to the normal level. "Loan certificates" at the banks were nearly all called in; "surplus reserves" at those institutions were restored. Now came that thoroughgoing reform of our banking and currency system, without which, financial Europe had for years declared, the United States could not aspire to high international prestige, and with which it was equally predicted we should win the full financial confidence of the outside world. All this series of propitious events had occurred in that notable month, November, 1914. To remove all doubt and misgiving which might still exist, on the part of other markets, there remained only one achievement—the reopening of the New York Stock Exchange to unrestricted transactions by the home and foreign investor.

None of the previous efforts to restore normal conditions—not even the decision to export gold in payment of our foreign debts—was surrounded with quite so much uncertainty as this. Of all the gloomy predictions made during August in regard to the war's effect on American finance, the surest and most logical seemed to be that Europe at the first opportunity would sell its three or four thousand millions of American securities at the best price obtainable. It had manifestly been doing that very thing when the stock

exchanges closed their doors on July 30, before the prodigious war expenditure had begun. Now, however, with 1914 drawing to a close, Great Britain was preparing to float a war loan of no less than $1,750,000,000, Germany was about to borrow $1,000,000,000, and the other belligerents had similar plans on foot. War loans of even greater magnitude were immediately impending. No such requisition on Europe's capital had been witnessed in history. The inevitable sequel seemed to be that all investment holdings of the European public, which could be turned into cash on other than European markets, would be sold at once to raise the funds for subscription to the war loans. But if this seemingly certain policy were to be pursued, what could avert a 25 or 50 per cent decline in prices on the New York Stock Exchange, with the complete derangement of the credit system which had apparently been imminent when the stock exchange closed its doors?

Such was even now the reasoning of the stock exchange committee. It was not, however, now accepted unqualifiedly by the financial community as a whole. What was suspected at the time, and what has been proved conclusively by subsequent events, was this: The enormous sales of our stocks by Europe in July had been an incident of panic, and panic was now averted. Even if foreign investors were to sell, they would now sell

cautiously and deliberately, with a view to getting the highest price obtainable. Finally (and this suggestion, though at the time considered very daring, turned out to be entirely correct) the immense financial prestige gained by the United States, in refusing to join the world-wide rush for a moratorium on debts, must so far have convinced the foreign capitalist of the soundness of the American situation that he would hold to what he had of them already and, if he sold at all, would sell reluctantly and slowly.

The stock exchange proceeded cautiously; but it was not left wholly in the dark. No market in which a large number of people really wish to trade can be absolutely suppressed, and after the stock exchange had closed down on July 30, it was not long before a group of individuals met on the sidewalk in the neighborhood of Wall Street, to experiment in buying and selling what was no longer bought or sold on the stock exchange. It was an irregular and unrestricted market; stock-exchange houses were forbidden to deal on it, and both banks and stock-exchange officials did their utmost to checkmate its activities. Nevertheless, the market in the street survived and flourished. Made up at first, perhaps, only of wagers by venturesome gamblers on the probable value of securities, this so-called "outlaw market" presently showed signs that bona-fide buying and sell-

ing orders were being executed in it. It must be remembered that the pressure for some avenue to trade in investment securities was very great. Estates must be closed out, holders of stocks and bonds have other uses for the money; people with an idle fund in bank wish to invest it, without waiting for reopening of a stock exchange.

By autumn, even the banking offices were keeping on file the daily printed circulars quoting prices of the "outlaw market" During the early autumn, prices on that market went below even the closing prices of the final panic day, July 30. By the middle of October, important stocks were selling 10 per cent or more under that day's quotations. Then, along with the numerous favoring developments in the financial situation generally, an unmistakable buying movement showed itself. It grew more active, within six or seven weeks the "outlaw market" had recovered most of the losses previously reported, and prices were again pretty nearly at the end-of-July level.

These things had happened in the face of the most vigorous opposition by stock-exchange officials. But meantime the stock exchange itself had not been wholly idle. In the third week of September permission was given for members to buy or sell bonds to one another; though all such sales had first to receive the approval of a special committee, and no sales were permitted below a level of

prices fixed arbitrarily a trifle under the closing quotations of July 30. In the middle of October, similar opportunity was granted to deal in a limited list of high-grade stocks. All this was done without the formal resumption of business on the stock exchange. Finally, on November 28, the doors of the exchange—closed during four consecutive months, whereas never before in Wall Street history had such suspension of business lasted longer than ten days—were officially reopened.

The date itself was interesting It was six weeks after the surplus in New York bank reserves had been restored; not quite two weeks after the new banking system had gone into operation; almost exactly a week after exchange on London had returned to normal parity, with consequent cessation of gold exports. It was also, by an appropriate coincidence, that very day on which the last of New York's clearing-house loan certificates was cancelled. Even now the stock-exchange officers proceeded with some misgiving. At first, open trading was permitted in bonds alone; a list of "minimum prices," close to actual prices of July 30, was published, no sales were allowed below that minimum, and speculative purchases or sales were rigorously forbidden—only transactions involving immediate cash payment being admitted. It was also stipu-

lated that every sale made on foreign account should be so stated to the stock exchange committee. These extreme precautions showed that apprehension of a "20 per cent all-around decline" had not yet been removed. But prices quoted, on this resumption of official trading, gave no indication of a downward tendency. They did not even stay at the arbitrary "minimums", instead, a gradual advance ensued.

After two weeks, therefore, stocks as well as bonds were admitted to this limited open trading, though with the same restrictions. The result surprised all Wall Street, for prices, instead of hesitating around the "minimums," began at once a vigorous advance, and before the month was ended had moved up in many instances 8 per cent or more. This advance continued into the new year, 1915. On April 1 all special restrictions of whatever sort on stock-exchange trading were removed. Home and foreign holders of American securities were invited to sell what they should see fit on the New York market.

This announcement was the final expression of financial America's full confidence in its own position. It removed from the New York market the last protective expedient of the war panic of 1914. Considered along with the notable incidents which had preceded the stock-exchange resumption, and with the further fact that no

investment market in the world, outside the United States, had returned to normal and unrestricted business, the effect on foreign financial sentiment was profound. A new and very extraordinary chapter in our economic history had begun.

CHAPTER VII

THE SECOND PERIOD

WE have now reached a point in our survey of the period where it is possible to see as a whole, and in their relation to one another, the makeshifts through which the civilized world, eastern and western hemispheres, belligerent and neutral states, struggled out of the convulsion which shook the economic firmament when the war broke out. Expedients, the suggestion of which would have been met with scornful incredulity a few weeks before August, 1914, and policies which, even when formally proclaimed, seemed merely to be the snatching at momentary support to escape complete financial shipwreck, had now—such was the logic of the events which had crowded on one another—taken their place as a consistent chapter in economic theory and practice.

This series of preliminary episodes may perhaps be best characterized as the fight of the civilized world to avert the greatest panic in economic history. The general insolvency which had been so widely predicted in advance was escaped, as we have seen, partly through the support, on a

quite unheard-of scale, of private by public credit; partly through temporary suspension of payments, not on the part of individual banks or markets but of communities, nations, and, for a moment, of the entire financial world. Recourse to these expedients had also helped to avert that complete collapse of international trade which the British foreign office had foretold on the eve of war. But the time had now arrived at the end of 1914, as it arrives in all great financial panics, when the sense of relief at escaping the seemingly unescapable catastrophe was superseded by a sense of the great and possibly lasting change in the world's economic relations. The "emergency expedients" had broken the force of panic, but they could not restore pre-existing conditions. When they had accomplished their specific task, the real economic influences called into being by the war began to exert their unhindered power.

It had, in fact, required nearly all of this five months' lapse of time for bewildered Europe to realize what this war was to be, even in its political and military aspects. Expectation that it would end with a short and triumphant German march on Paris, or with a crushing counterblow by the Allies, was no longer tenable, in or out of the financial markets. During this period the Belgian resistance had broken down. Liège and Brussels had fallen. The German army had

swept almost to the gates of Paris. The French Government had removed to Bordeaux. The Germans had been defeated at the Marne, Paris had again become the seat of government Retreating far to the northward, Germany's soldiers had begun the trench fighting on the western front, which was destined to create a military deadlock of nearly two years' duration.

Russia had invaded Germany and been driven back. England had swept the seas of German shipping and blockaded the Teutonic ports. Turkey had joined the war and closed the Dardanelles German cruisers and Zeppelins had bombarded unprotected English coast towns, and the shameful story of German brutality and plunder in unhappy Belgium had become known to the civilized world That this would be a long war, a destructive war, a war costly beyond the furthest previous flight of imagination, and a war in which international bitterness and hatred would reach unparalleled intensity, was now plain to the least experienced observer. The second economic chapter of the war was about to begin. It was marked by a distinct and rapid change in the actual position of both belligerent and neutral markets, but it was notable beyond all else in the completely altered relations which it introduced between Europe and the United States. This chapter of events began with 1915.

The European moratoriums had by the end of 1914 been in large measure abandoned, the machinery of the credit system was at work again Except for Germany and Austria, whose coasts were blockaded by the British fleet, and Russia, whose ports were closed on the Baltic by Germany and on the Black Sea by Turkey, the larger belligerent states had resumed activities in foreign trade, though on a greatly restricted scale; export of English products during the whole of 1915, for instance, being cut down more than one-fourth from the last full year of peace. From the financial point of view, the alignment of the various fighting Powers was now highly interesting

The results of the crucial economic test through which each had passed were in many respects startling, and in some quite unexpected. England, although she had successfully averted a collapse of credit, had been shaken in prestige by the moratorium, and was about to relinquish voluntarily, for the period of war, her position as the central market of the world. France, which a few years before had been lending money to Germany, to the United States, and even to England, found herself in a seriously crippled financial position, in which (partly because the enemy was still on French soil) her government was unable to place long-term loans either abroad or at home. Germany's success in raising enormous sums

through domestic loans, in the face of the embargo of her international commerce and finance, had amazed the world. But her currency was depreciating; a premium was bid on gold until the Bundesrath imposed prison sentences on all who repeated the exploit; the foreign exchanges were moving rapidly against her, and she had to contend, in her economic as well as her political relations, first with the gradually tightening grip of the blockade on her food and supplies, and next with the overwhelming condemnation visited on her conduct by the neutral world, and the firm belief of that outside world in her eventual defeat.

These new aspects of belligerent Europe's economic position had much to do, as we shall presently see, with the altered course of events financial in the United States. Two new and very striking incidents of the period had immediate bearing on the situation in both Continents. One was the action of the European Powers in regard to their gold supply, in which some entirely new economic precedent of war time was established, the other was the discovery of what they would have to buy from producers in neutral states. Experience in former wars had taught the financial world that, in a conflict of larger magnitude, a belligerent country would rapidly lose its gold through export. Such a movement always indicated either transfer of capital from

the uncertainties of a fighting state to the refuge of a neutral market, or inflation of paper currency, which, in the familiar machinery of finance, would drive out gold, or both influences combined. Both were reasonably sure to operate in the existing case of Europe.

In former wars they had operated notwithstanding suspension of gold payments at the banks and public treasuries, such as was publicly announced in Germany during August, 1914, and tacitly put into effect by France Yet the government, first of Germany and then of France, took this time the quite unprecedented step of calling on its citizens to surrender voluntarily, in exchange for paper money, the gold in their possession. It must be remembered that in previous great wars, payment of gold by citizens to the government had always ceased. It became, actually or prospectively, worth more than other forms of currency. Merchants who had to use it in their foreign payments paid a premium to get it. Even the public treasury, when it needed gold for remittances to foreign countries or for interest on its debt, had to bid a premium, paid in its own depreciated paper. The exodus of gold from the United States in our Civil War was so well-known a phenomenon that politicians who desired to perpetuate the depreciated paper currency, and who opposed return to specie redemption of

it after the war was over, were accustomed to refer in their campaign speeches to the "blood-stained greenbacks" which had stayed with the armies and the people while the gold was making its cowardly flight to Europe.

The natural order of events in continental Europe of 1914 would have been the same. But the German Government, having by law forbidden export of gold or the bidding of a premium for it, issued a proclamation urgently insisting on the exchange for imperial bank-notes, at face value, of all the gold held by its citizens. This proclamation rested its demand partly on grounds of patriotism, but partly also on the argument that gold was of no use to a private citizen and that paper currency was all that he had a right to ask for. It ended with the curious assurance that the imperial post-offices, at which gold would be received in exchange for bank-notes, would make no charge for the conversion. I have already referred to the hoarding of gold in enormous sums which had occurred in continental Europe during the "war scare" after 1911. Responding to this appeal, the gold emerged from its hiding-places. In the autumn months of 1914 nearly $20,000,000 a week was thus turned over to the German Government. During the first seven months of war, no less than $250,000,000 gold was added to the imperial bank's reserve, and of this only $50,-

000,000 came from the government's own "war chest," maintained since 1871 at Spandau Castle

In the middle of 1915 the French Government made a similar appeal to its citizens, basing its request for exchange of gold on the plea of patriotism, and, after a fashion characteristically French, bestowing on every citizen who brought in his gold an official certificate of service to his country. Within seven weeks, $100,000,000 gold had been received by the Bank of France. It could have come from nowhere but the hoards of private citizens, and upward of $150,000,000 more came in before the end of 1915. Since neither the French nor the German Government was paying out gold, the upshot of these remarkable operations was that the gold was still being hoarded, but by the public treasury, not by individuals. What will eventually be done with these immense accumulations—by far the largest ever held by the two state banks—remains to be determined later. The gold might conceivably be used, at the end of war, to pay indemnities. It might serve to facilitate return to gold redemption of the paper currency. It might be used exclusively for payment of interest and principal on foreign indebtedness incurred during the war. The salient fact is, that the world had witnessed an absolutely new achievement in economic history.

The course of the British Government was dif-

ferent. Gold payments had not been suspended at the Bank of England; the government's early offer to suspend the bank act had been rejected. As we have seen, the early months of war were marked by large gold exports from New York for account of London. Shipment of this American gold to the Bank of England's newly established branch in Canada, and the deposit with its South African branch of the $14,000,000 gold produced on the average each month from the Transvaal mines, increased the total gold holdings of the bank from the $138,000,000 of August 7, 1914, to $362,500,000 in the middle of November; this, like the holdings of the French and German banks, being much the largest gold reserve in the institution's history. But we have also seen that November, 1914, marked the turn in America's economic fortunes. The New York market had paid its maturing liabilities to Europe, had protected its own credit, had given plain evidence to the outside world of its confidence in its own position. At the very moment when an English commission had arrived at Washington, with the belated purpose of helping to remove our difficulties on the international market, the whole situation altered.

Exchange on London had fallen to the normal parity, and our gold exports to England or Canada had ceased. In another month or two, ex-

change was moving so rapidly in this country's favor that the gold previously sent from New York to Canada was coming back again, and before the middle of 1915, all of it had returned. During the whole of 1915 the United States imported no less than $451,900,000 gold, or nearly $300,000,000 more than in any previous year. Of this huge sum, two-thirds came from England and Canada, the Bank of England's Ottawa reserve giving up $218,000,000. Despite the new supplies received by it from the Transvaal mines, the bank's gold holdings fell from the $362,500,000 of November, 1914, to $251,000,000 at the end of the next year. We have next to ask what were the causes of this extraordinary reversal of conditions.

Our enormous export of wheat was the first. That influence had not been overlooked beforehand; for war, which often means the blockade of belligerent producers, affects the wheat trade first among all industries. Food must be had at any cost, and the uncertainties of war therefore created abnormal demand, even in such minor conflicts as the Franco-Prussian War and our Spanish War of 1898. The Napoleonic period was marked by two memorable famines, in one of which, wheat at Liverpool reached the highest price ever known. Circumstances in the world's grain trade, when this war broke out in 1914, were

somewhat unusual. The United States was about to harvest the greatest wheat crop of its history. The 891,000,000-bushel yield of the season exceeded by 127,000,000 bushels, or nearly 17 per cent the country's previous maximum Before war began, the price of wheat was falling; the grain trade doubted its ability to sell, except at greatly reduced prices, the surplus which would be left after meeting the needs of home consumers

But this aspect of the situation soon changed in a very dramatic way. In face of the unprecedented American harvest, the crop of 1914 in the whole wheat-producing world, outside the United States, turned out to have decreased 367,000,000 bushels, or 11 per cent, from the preceding year. This was only one of the offsetting considerations. Not only was the wheat crop of Europe, Canada, and Australia so much below the normal average as to have caused a troublesome shortage in grain-importing states, even without the war, but the area of battle at once extended over some of the most fertile granaries of Europe, and meantime Russia, one of the two largest wheat-producing countries of the world, was instantly cut off from the export market. In the twelve months ending with June, 1915, as a result of these remarkable coincidences, the United States exported 180 per cent more wheat than in the year before, the value of the export increasing $245,000,000. The

American harvest of 1915 reached 1,000,000,000 bushels

It was in December, 1914, that our huge grain export so far counterbalanced the decreased shipments of other commodities that our total outward trade, for the first time in the war, ran beyond that of the same month a year before. Early in 1915, another and a yet more powerful influence was thrown into the scales. The deadlock of the military campaign in western Europe had convinced the Allies that only through overpowering superiority in artillery could they beat back the German army. England and France set to work at once "mobilizing" their own industrial plants for manufacture of ammunition; but this was not enough. Orders in prodigious quantity were placed with American contractors, by whom the machinery in manufacturing plants of every sort was adjusted to making shells, rifles, powder, and bullets. As yet it is merely a matter of estimate what the total of such orders was. Wall Street at one time figured it at $1,000,000,000. On the basis of official reports, it has been shown that, in the twelve months after the shipments began, $500,000,000 of such material was exported from the United States, and a very great part of the purchase price was paid by Europe in advance.

Under such varying influences, the country's

total exports rose to stupendous magnitude. This result was one of the unexpected economic phenomena of the war; history gave no precedent for it. It is true that the United States, during the early years of the Napoleonic conflict, enlarged its foreign trade in a spectacular way. In 1801 we exported $94,000,000 worth of goods—a very substantial increase from the previous decade; in 1807 they had reached $108,000,000. But this older war-time increase was not at all made up from larger shipments of our home products to belligerent Europe. It arose almost exclusively from the fact that the activities of European war-ships, in capturing enemy cargoes on the ocean, threw over to the neutral American shipmasters the immensely lucrative trade of the West Indies.

Eventually, the bulk of such shipments were consigned to American ports, whence they were promptly reshipped to Europe. Whereas, in 1792, this total of "foreign merchandise re-exported" from the United States was reported by our government as only $2,109,000, in 1799 it had risen to $45,523,000, and in 1806 to $60,283,000. How extraordinary that achievement was, judged by the period itself, may best be judged by the fact that the total of such re-exports in 1806 was not duplicated until 1915. But the main influence on our trade of 1915 was altogether different. Our

merchandise shipments of that year to such outlying continents as Asia, Africa, and Australia did indeed run $42,000,000 beyond the largest previous yearly total, while the exports to South America rose $54,000,000 above 1914, and exceeded all other years but one. This was itself a consequence of the war and of the war's paralysis of Europe's industrial activities. But how relatively small a part this trade with other neutral countries played in the total increase of our exports on this occasion, is clearly shown by the fact that our outward trade in merchandise during 1915 ran $1,433,000,000 beyond that of the preceding year and $1,063,000,000 beyond the largest previous yearly total in our history.

Two-thirds of the increase over 1914 was accounted for by consignments to England and France, and it was a peculiarly interesting fact (not without diplomatic significance) that whereas our direct exports to Germany and Austria decreased $158,000,000—in fact, disappeared almost entirely—nevertheless, our exports to Holland, Denmark, Norway, and Sweden increased $154,800,000 over 1914, and exceeded even the last full year of peace by $182,800,000. Prior to 1915 the highest figure ever reached by our total surplus of merchandise exports over imports was the $691,000,000 of 1913. The surplus for the calendar year 1915 was $1,768,000,000. In the twelve

months ending with June, 1916, it was $2,136,-000,000

I have already quoted the comment, made at London in the autumn of 1914, that New York had "missed the chance of a century" to take London's place as the financial centre of the world. Only two or three months later, Lombard Street itself was admitting that, for the period of war at any rate, New York had already gained that position It was early in January, 1915, when the British Government officially announced that English capital must be reserved for the war financing of Great Britain and her allies, and that no new loans of outside communities or governments were thereafter to be floated in London without the government's consent. From this plain declaration of policy it was instantly inferred, first, that London had ceased for the period of war to be the active money centre of the world; second, that no other market could undertake that work except New York; and, third, that the financial shoulders of the United States were now broad enough to bear the burden.

The task, thus transferred to the American market, of providing money for the urgent financial necessities of outside communities, was performed cautiously. It was a new experiment for us, and began under unusual conditions. But our

bankers underwrote loans in the hundreds of millions to the South American republics, to Canada, to Switzerland, and the Scandinavian states, and in return New York undoubtedly became for the time the money market of the world.

The "central money market" must be that market to which the rest of the world applies for credit. It must discount, for the merchant conducting foreign trade in one community, and for the period of the business season, drafts sent forward by merchants in another community against goods sold to him, and must therefore provide the working capital for international commerce. It could not have been expected that the New York banks would be able on the spot to do this on the scale of London's activities before the war. But international trade had been greatly reduced in volume by the war unsettlement. Our own home demands on credit were relatively light. London, though it had ceased to put its money into the securities of foreign markets, continued to do a discount business for those markets, and New York therefore made its entry into the field without an undue strain. It not only subscribed in large amounts for new securities of Canada and the South American communities, but entered directly on London's business of providing the capital for international trade. At the beginning of 1915 discount of

"acceptances," based on a foreign merchant's export of goods, was practically unknown in New York banking, at the end of the year it was officially stated that $100,000,000 of such bills of exchange were in the hands of American banks.

Now, a market which performs these services for foreign communities, like a bank which performs them for its own town or city, pays out its capital in loans; but in return it gets back capital in deposits, which is the real source of profit; and this was necessarily the experience of the new money centre. Merchants in other neutral markets transferred from London to New York the balances on which they were accustomed to draw in connection with their foreign trade. American banks and merchants to a very great extent recalled from London the balances previously carried there for the same purpose. This process had an important double influence on the economic phenomena of the year.

It greatly increased the aggregate of payments which England had to make to the United States. It also added a huge amount to the available capital on the American markets. The first influence operated on the rate of exchange between New York and London, with results which we shall presently have to examine. The second went far toward explaining the extraordinary achievement of the American market during 1915, in

which year the United States not only repurchased from Europe American securities commonly estimated at $1,000,000,000, but, in addition, purchased more than $1,000,000,000 of new securities issued by belligerent and neutral European countries, by Canada, and by the South American republics. This was an innovation. American investors had never been in the habit of lending money largely to the outside world; New York's investment in England's war loans during 1900 and 1901, and in Japan's war loans during 1904 and 1905, was of a temporary nature and on a relatively small scale—only a little more than $300,000,000 in all. It was quite inevitable that this tangible display of economic resources, in the face of the European War, should have encouraged the movement of capital from outside markets to the United States.

The financial community itself was curiously slow to recognize what all this meant to the question of America's own prosperity. When the European War began, the question asked with special urgency in American business circles was how the United States could be safeguarded from a period of financial adversity. Eight or ten months later, the prospect of immediate financial reaction was conceded to have disappeared, and vague talk began of the business revival which this powerful neutral country might expect after

the war. Even when, in the autumn of 1915, the question was put to one of the most eminent of our practical manufacturers, "Is the United States headed for unprecedented prosperity?" and the reply was, "It is enjoying that prosperity now," the diagnosis was widely disputed, in Wall Street itself. Prosperity, however, is sometimes a matter of definition. What one merchant, banker, or speculator would describe by that title, another would dismiss as not measuring up to it at all. If by prosperity we mean such a period as 1901 or 1906, when every one seemed to be making and spending money lavishly, when the word passed current that "nothing can stop the good times," and when the spirit of hopefulness over any and every kind of business undertaking was apparently under no restraint—then the conditions existing in 1915 would certainly not meet the test. But there is prosperity and prosperity; and it soon became possible to appeal to well-known criteria which had long been accepted, in financial and industrial circles, as indicating whether real prosperity does or does not exist.

The London market, as even the English histories show, has traditionally made great account of the movement of the foreign exchanges, for or against the country whose prosperity is in question. If this were to be the test, the prosperity of the United States in 1915 would have stood

unchallenged; it is doubtful if ever before in economic history had the rates of exchange on all the rest of the world moved so powerfully in one market's favor as they moved in that year in favor of New York. The economic derangement of Europe by the war, however, made this rather more a test of relative than of actual conditions

The stock market, if its action is sufficiently continuous and emphatic, is another quarter where at least the premonition of prosperity is expected. It is "the pulse," Macaulay said, "which during four generations has continued to indicate the variations of the body politic." It performs this office, chiefly because a prolonged and general rise in prices should reflect expectation, by the best-informed people in the country, of increasing business profits for the transportation and manufacturing properties whose shares are sold on the stock exchange. For obvious reasons, this is a test which must be cautiously applied. Currency inflation will stimulate advancing prices, measured in paper money, when gold values may even be declining. This made the stock exchange almost a useless criterion in our Civil War. Experienced people would not take one of those outbursts of wild speculative mania, which at intervals derange the whole financial organism, as prophetic of sound prosperity. On the stock markets of 1915, something like that was witnessed

in the extravagant rise of shares of companies manufacturing war supplies. But that movement reached and passed its climax; prices of such stocks, after rising 25 to 100 points, lost half of the preceding rise, or more, in a violent collapse. Yet at the same time a long series of railway stocks, in which prices had risen fully 20 per cent since the early months of 1915, held stubbornly to their higher values.

Among these were shares of the most conservative American railway companies, whose fluctuation on the market measures the attitude of serious investors. What was not least remarkable, the home demand which served to bid up prices for these stocks was so obstinate as almost wholly to offset the influence of Europe's sales to us of its own holdings of these shares. Europe had been selling back our best railway and industrial bonds also, and it had become a matter of common prediction that a violent fall of prices for American bonds must be inevitable as a result of the high European bid for capital. Yet what happened in November was the largest dealing in bonds that the stock exchange had witnessed in half a dozen years, and an advance in prices so rapid as to bring them nearly or quite up to the earlier high level of 1914.

These indications showed chiefly what was expected. There were other indications of what

must actually have occurred. One very familiar test of active and prosperous trade, financial observers find in what are known as the country's clearing-house exchanges. Every bank, receiving as deposit from a client the checks drawn in his favor on other institutions, sends those checks to its district clearing-house, whence they are forwarded for collection to the banks on which their maker drew them. From this process it results that the total money value of the checks thus exchanged, in a given period at all American clearing-houses, indicates accurately the total payments made in connection with the business activities of the period. The actual figures are carefully tabulated. Until the autumn of 1915, the largest weekly total of such bank exchanges in this country was the huge sum of $4,868,000,000 in the first week of 1910. But in the third week of November no less than $4,903,000,000 checks changed hands—an increase of 74 per cent over the same week in 1914, of 42 per cent over 1913, and of 37 per cent over even the very active business season of 1912. No month in the country's history had ever approached, in the total magnitude of checks drawn for business purposes, the closing month of 1915. During the first half of 1916, the total rose nearly 40 per cent above the highest record for any previous corresponding period.

The monthly statements of the country's iron production are an even more tangible sign of industrial activity. When business in general is reviving and the outlook for active and profitable general trade is bright, orders at once increase with the iron-mills. The reason is, that every other industry has to increase its steel and iron equipment in preparing for an active season. The farmer needs new agricultural machinery. Merchants and miscellaneous manufacturers wish to enlarge their working establishments. The railways must have more cars and locomotives and rails; the steel-mills themselves will be adding to their own productive facilities. Active demand for all these prospective purposes will be seen in the steel and iron trade's order-books, even before the signs of visible activity have appeared in the industries which want the new material. These are the reasons why iron is known traditionally as the "barometer of trade," and why a rise in steel and iron prices, and steady increase in steel and iron production, ordinarily mean general trade revival.

At the end of 1912, just before the industrial revival stimulated by what were then our record-breaking crops had been checked by the dangerous turn taken in the Balkan War, all precedent was surpassed in American iron production. The average daily output of 92,600 tons, reached dur-

ing February, 1913, remained the maximum of the country's history until September of 1915. That month ran slightly beyond the 1913 figure; the next month's average daily output crossed for the first time the 100,000-ton mark, and the total monthly output went in October—again for the first time in the trade's records—beyond 3,000,000 tons. The monthly average for the year of largest production in our previous history had been barely 2,500,000. "Never before," the *Iron Age*, a highly conservative organ of the industry, remarked of these October figures, "has the steel trade seen demand so overwhelming, and at the same time its output expanding on such a scale, under steadily rising prices." Yet only six months later, the output was ten per cent greater

One obvious criticism on the testing of prosperity by the steel and iron situation alone was that orders for war munitions, placed in this country on so great a scale, had been an immense stimulus to that industry, yet were not in the nature of a permanent influence. There was force in this objection; it was largely offset, however, by the fact that these very requisitions for use in war supplies had started up inquiry for other purposes from home consumers. It was their demands which brought the steel trade, in the early months of 1916, to the actual limit of

its producing capacity. There was still another test of active trade which always appeals to the financial markets. By the middle of October the railway tracks and terminals, East and West, began to be blocked with freight. No such visible overflowing of transportation facilities by offerings of traffic had been witnessed in this country since 1906, and it is doubtful if the strain had been equally severe since the sudden and rapid trade revival of 1899 caught the railways utterly unprepared.

As early as September, 1915, the Pennsylvania Railroad reported the largest total earnings, and the largest excess of earnings over working expenses, of any month in its history. If it be said that this, too, may have largely meant the munitions trade (the Pennsylvania runs through Pittsburgh), there were other railways to compare with. When their October statements were given out by railways in the Middle West, in the Northwest, on the transcontinental route, all were substantially up to the highest previous record for the month, and a considerable number, like the Pennsylvania in the month before, surpassed all previous monthly figures. These at least were no matter of war materials. The general manager of one of the largest railways running between Chicago and New York remarked at the end of November: "People who think the war munitions

are blocking the movement of freight should spend a few minutes in our freight-yards. You will find them blocked with cars loaded with meat, automobiles, locomotive and freight-car parts, and a thousand commodities not used in war, and you will find the freight consigned not only to Europe, but to South America, India, and all the rest of the world."

More than this: in the last week of October, deliveries of grain by Western farmers to the railways, at what the grain trade calls the "primary receiving points," not only rose 10,000,000 bushels above the same week in 1914, but exceeded by not quite 6,000,000 bushels the 30,990,000 bushels delivered in the third week of September, 1912—which, until the autumn of 1915, were the high mark of the grain trade. This itself reflected yet another traditional weather-sign of reviving industry: the fact that, by the government's final autumn estimate, the yield of the country's five great grain crops was 5,892,601,000 bushels, as against 4,942,613,000 actually harvested in 1914, and 5,532,838,000 in the most abundant previous season—that of 1912.

What all this signified should have been plain enough. The tests thus applied covered practically every measure of business prosperity, and each gave emphatic witness to the existence of such prosperity. There still remained, and will

doubtless continue to remain, a body of opinion which, conceding all these evidences, held the position that prosperity was ill-distributed among the different industries and the different sections of the country; but, more than this, that whatever prosperity existed was precarious, temporary, based on wholly abnormal influences. In other words, the conditions thus suddenly created during 1915, and continuing throughout the next year, merely represented one of those "war booms" which history records at the crisis of all great conflicts, even in the belligerent communities—prosperity of the kind which induced the furious activity of 1809 in England and 1864 in the United States, but which ended in each case in the prolonged reaction of a few years later.

Neither of these contentions can be lightly dismissed. Yet it is pertinent to ask whether, even so, they affected the question whether American prosperity was actually under way. There has never been an American trade revival of the past in which some industries and some communities, for reasons peculiar to themselves, did not hang back behind the others. There has never been a period of American prosperity—even in the so-called "boom years" of 1872 or 1880 or 1901 or 1906—which did not have something of the temporary and the precarious about it.

If, indeed, the American industrial revival of 1915 had as its sole basis the "war orders" from Europe, and especially if it was stimulated by an inflated paper currency at home, there would be something more to say. But neither of these conditions actually existed. The fundamental phenomena were the soundness of economic conditions in the country on which these unexpected windfalls descended, and the rapidity with which the movement of expansion extended to industries dependent on domestic orders and on the needs of peaceful trade. It is even possible to construct a theory of the existing situation as a trade revival accidentally and artificially postponed. In America the tradition of the "cycle of prosperity" is invariable, to the effect that after a great financial panic five or six years (not more) are needed for liquidation and recuperation; after which the great forward movement begins again. It began in 1879, following 1873, and in 1898, following 1893, and many signs indicated resumption in 1912 of such a movement, when the reaction of 1907 had spent its force. In what way this return to American prosperity was arrested by the political apprehensions and disturbances in Europe, every one knows.

Sometimes compulsory postponement of so normal a movement of recovery means that the forces making for legitimate expansion at the

earlier date will have grown stronger for being held in check. At all events, it is under precisely such circumstances that the United States will confront the changed world, with its new financial and industrial conditions, which is to emerge from this war whenever peace actually returns. Nothing will then be quite as it has been in the past; all economic relationships between the different nations will be altered. But the position occupied by the United States at the beginning of the new economic era will be something very striking, very unusual, and economically very poverful.

CHAPTER VIII

CURRENCY INFLATION

THAT inflation of the paper currencies of the belligerent states would be an inevitable incident of such a war as this, was the unquestionable teaching of history. Depreciation in such currencies was singularly absent from financial calculations at the outbreak of the war; this notwithstanding the very general prediction of economists, in previous discussion of the probable phenomena of a general European conflict, that gold payments could not be maintained under such conditions. Yet experience had taught that every prolonged and costly war of the preceding century had been characterized by issue of paper money, in such quantity as to exert far-reaching economic influence on the markets In the course of our own four-year Civil War particularly, the United States Government issued $450,000,000 of paper money; our actual paper circulation increasing, between 1861 and 1865, no less than 270 per cent. Government calculations of the average prices of commodities in this coun-

try showed an advance of 116 per cent during the same period, and that movement was accompanied by a violent rise on the stock exchanges, and by what seemed to be a notable forward movement of prosperity.

There were secondary causes for the war-time rise of prices in the sixties, and for the resultant speculative expansion; among them the War Department's purchases, the blockade of the South, and the rising price of a labor market depleted by enlistments in the army. But no intelligent reader of history doubts that the primary cause was the paper-money inflation. Since the after-results of that inflation were disastrous, it is not unreasonable to ask whether our financial and industrial revival of 1915 may not have been based on similar causes, and may not be destined to a similar unhappy end.

Taking the world at large, there is no doubt whatever as to the fact of paper-money inflation during this present war. Between July, 1914, and the middle of 1916 Germany's paper currency increased from $473,000,000 to $1,740,000,000, or something like 320 per cent. France brought its bank-note issues from $1,336,000,000 to $3,100,000,000, an expansion of 131 per cent. In Russia, the Imperial Bank's note issues alone, which were $930,000,000 at the outbreak of the war, reached $2,650,000,000 at the end of 1915 and

$3,100,000,000 three months later. This was an increase of 336 per cent, and there was probably other currency put out. Austria has not ventured to publish the figures of her war-time paper-money issues, but they were certainly very large

The Bank of England's note circulation had increased by the middle of 1916, as compared with July, 1914, only from $148,500,000 to $176,500,000, or less than 20 per cent. But the special currency authorized by the British Government when the war began—put out by the treasury for account of the English joint-stock banks, and secured by government bonds, commercial paper, and, during 1915 and 1916, by $142,500,000 in gold—had risen by the middle of 1916 to no less than $586,000,000. Including this amount, the increase in England's paper issues, since the war began, was 515 per cent. It is true that these English "currency notes," being secured in part with gold, obtain a character which the $300,000,000 or more of "Darlehnskassenscheine" in Germany (against which no gold at all is held) do not enjoy. It should also not be overlooked that while the Continent's currency expansion of war time came on top of bank-note circulations only partly protected with gold, the Bank of England's own note issues, now as heretofore, are secured in gold up to their full face value. Nevertheless, we are primarily investigating inflation of

European currencies, and the fact of immense expansion appears in all of them.

There are three main reasons why every prolonged war of modern history has been attended by this inflation of paper currencies. One is, that the experience of the race has taught people to hoard gold and silver when their country plunges suddenly into the uncertainties of war. That action makes it necessary to provide a substitute for coin in hand-to-hand payments. Another is that gold, the international currency, is apt to be sent by its owners, for safe-keeping or as a means of transferring capital, from the markets of a belligerent state to those of a neutral country—which may similarly create a void in the fighting country's circulating medium. The third reason lies in the fact to which I have referred already; that paper currency, created by a government, may be used to meet at least a part of that government's immensely increased expenditure during war.

All three of these influences had some hand in the war-time inflation of Europe's paper currencies. But almost all of the new currency issued by the belligerent states has in this one respect differed radically from that of former war-inflation periods—it was not, like our greenbacks of the Civil War and the assignats of the French Revolution, government fiat money, put out directly

by the national treasury to pay the expenses of government. Most of the new European paper money of 1914 and 1915 was issued by the central bank of each respective belligerent, and had to be offset, on the balance-sheet of the issuing institution, by a corresponding sum in commercial loans, or public and private securities, or actual gold and silver.

But, on the other hand, the bank could issue its notes to the government, taking new government bonds as security; and since single war loans of the belligerent states have been made in sums as large as $3,000,000,000, it was possible that the new currency should, by this process, pass directly into the government's hands, and be used for meeting current public expenses—just as an old-time "fiat-money issue" would be used. With the Bank of France, for instance, the $1,525,000,000 increase in its note circulation, between July, 1914, and the maximum figure of 1915, was offset on the other side of the account by $1,480,000,000 under the entry, "Advances to the State for the War."

As to precisely what has been the effect on Europe itself, of this enormous currency inflation, it is still early to draw conclusions. On the Continent, gold redemption of the paper currency, which was in force in all the important states before the war, was formally or tacitly

abandoned, as soon as the war began. An open premium on gold was not, however, paid in 1915 or 1916 on any European market; that evidence of currency depreciation was averted in Germany by penal statute, and in France, apparently, by common consent. But this still left the rate of exchange on the markets of such countries, current in neutral cities, to measure actual depreciation. The rate of New York exchange on Paris or Berlin, for instance, merely means what American bankers will give in American money to a merchant for his claim on a solvent French or German debtor, payable in France or Germany in the currency of that country.

Since the bankers, under existing conditions, paid gold or its equivalent for the draft, while knowing that it would not be redeemed in gold in the market on which it was drawn, they could scarcely be expected to pay as much for it as they paid in days when it commanded gold. There have been other causes, presently to be examined, for the depreciation of exchange rates on belligerent Europe at New York. But this cause was so entirely obvious that depreciation in continental exchange would unquestionably have resulted from it, even if the "merchandise trade balance" had remained as it was before the war. The fact, then, that whereas a franc is worth intrinsically 19.3 cents in American money, the New York

dealer in exchange paid only 15.7 for it early in 1916, and that whereas a German mark, on the specie basis, is valued at 23.8 cents, it brought less than 18 cents, was in very large measure the reflection of a neutral market's effort to measure the difference between gold values and the value of a depreciated currency.

But the inflation process has not produced on Europe's markets the effects which followed it in this country after 1861. It is true that English prices of commodities have risen violently—the London *Economist's* monthly "index number" of average prices had reached 4,319 at the end of May, 1916, as against 3,250 in the middle of 1915, and 2,565 when the war began. For this, however, as for the similar rise on the European Continent and the striking though less violent advance in the United States, the prodigious demand for all kinds of war material, the blockade of producing countries, and the abnormally high ocean freight rates are sufficient explanation. But there was no excited "boom" in European business, except for the war contractors and the lucky owners of ocean steamers; no enthusiastic speculation for the rise on the stock exchanges. That was, perhaps, because the artificial stimulus of inflation had been only sufficient to counterbalance the crushing financial burdens of the war, avert a general collapse of enterprise and credit, and

maintain some sort of equilibrium on the markets.

This very fact, however, brings up the question whether the markets of the United States, where the burden of war did not exist, might not have owed their condition of aggressive prosperity to inflation. It is true that the fact of a premium, not a discount, on American currency in the terms of foreign money, might be taken as prima-facie evidence that our own currency was in a normal condition, and it is certain that the American paper currency continued to be redeemed in gold. Nevertheless, it was inevitable, when all the original predictions as to the effect of the European War on American finance had been upset—when actual results had turned out precisely the contrary of what the most sagacious home and foreign opinion had foreshadowed—that some people should presently begin to doubt the reality of the achievement. This country had habitually looked to Europe for the loan of money to meet the expenses of harvesting our crops and sending them to market; the loans, very large in amount, being repaid from the subsequent export of our produce. The war and the war loans put an end to such assistance. London no longer had anything to spare for loans to America. Severe stringency in New York's autumn money market was, therefore, not il-

logically predicted. Yet the largest grain harvest in our history was financed from home resources during 1915, with the American money market unruffled and rates almost the lowest on record.

European investors held in July, 1914, as they had held during many decades, three to four thousand million dollars of American securities. In the half-dozen preceding years we had managed to provide for our own industrial necessities only by selling several hundred millions per annum of newly issued stocks and bonds to Europe. Europe, however, was now not only unable to continue such purchases, but her investors were certain to sell back to us in enormous quantity what they had already, in order to raise money for the $10,000,000,000 or more of war loans issued annually by the belligerent governments.

It has been calculated by the most careful statisticians that at least $1,000,000,000 of American securities were resold by Europe to New York between the reopening of our stock exchange in December, 1914, and the end of 1915. Yet not only did the American market take them, but it loaned, on its own account, a sum only slightly less to foreign countries which had always heretofore sold their new securities in France and England; and, in the face of this double burden, prices on our stock and bond markets actually

rose beyond the level which prevailed before the war.

It was undoubtedly our enormous export trade, first in grain and then in war munitions, the resultant increased command over European capital, and the great amounts of capital which other neutral markets transferred from London to New York, which primarily explained the ability of the United States to perform this bewildering achievement. The unprecedentedly large import of gold from Europe to the United States had a hand in the result; it provided a basis for legitimate expansion of bank loans, whereby these large home operations could be easily financed. But the transactions themselves so completely overtopped anything in our previous financial history, and were conducted in such sudden sequence to a period of seeming weakness and reaction, that these explanations did not appear sufficient.

It is not therefore to be wondered at that cautious people should have begun to ask if there was not something unreal, something fictitious, and therefore something precarious and temporary, in this display of unheard-of prosperity. A well-known financier, one of the members of our national banking commission, in 1915 described the attitude of American financiers as embodied in "two schools of thought, one looking into the future with unbounded confidence, and the other

anticipating drastic reaction and collapse" More specifically, the question began to be put, whether the United States, along with the rest of the world, might not have entered an era of currency inflation. Experience had taught that inflated paper money is the best-known necromancy for creating illogical and impossible conditions in the way of national prosperity—though with after-results which justify all the warnings of the sceptics.

One admitted fact might have been deemed to indicate the existence of that influence; the issue by our banks under government supervision, in the first three months after July, 1914, of $380,000,000 in "emergency currency." There was yet another possible influence toward such artificial stimulus. Under our new banking system, put into operation four months after the war broke out, the Federal Reserve Banks of the twelve designated districts were empowered to issue circulating notes on certain prescribed collateral, provided they kept on hand a 40 per cent reserve in gold. The gold in the vaults of these institutions at the end of 1914 bore that percentage to $625,000,000; at the end of 1915 they held in gold 40 per cent of $896,000,000. In theory at any rate, issue of that much in new paper currency was possible. Here was apparently the machinery for such expansion of the American paper currency as

would cut a respectable figure, even as compared with Europe. Was the Federal Reserve currency, then, a governing influence in the unexpected chapter of prosperity which began in the middle of 1915, or was it not?

The answer is not difficult, and it is quite the reverse of what a good many people, even those of practical experience, seem to think. That the successful establishment of the new banking system was an important factor in promoting financial confidence, and thus in clearing the ground for last year's American revival, there can be little doubt. Knowledge that its facilities were such as to meet, effectively and instantly, the necessities either of a "financial boom" or a "financial panic," removed much of the pre-existing apprehension. But, contrary to very general supposition, those facilities remained to all intents unused during the great revival of American prosperity in 1915. Therefore they cannot have been a factor of "inflation." The $380,000,000 emergency currency, issued at the beginning of the war, had all been retired and cancelled before the end of June, 1915. During that cancellation process, the Federal Reserve Banks were beginning to issue notes, and a substantial amount of them is now outstanding. Yet our total bank currency, old and new, which aggregated $1,121,-000,000 on November 1, 1914—just before the

new banking system was introduced—stood only at \$985,400,000 on January 1 of 1916. It had been reduced to \$929,300,000 by the middle of 1916.

In other words, the country's paper currency decreased, not increased, during the war-time revival in American finance. The point is occasionally made that, whatever may have happened since November, 1914, the sum total of bank-note currency outstanding in the middle of 1916 was, nevertheless, \$186,000,000 greater than at the outbreak of the war in August, 1914. This is quite true, and \$176,000,000 of that increase consisted of the new Federal Reserve notes. But in that direction also, some very significant facts are commonly overlooked.

Under the law, a reserve bank may keep notes outstanding, either secured with commercial paper pledged by individual banks in the district, or secured, dollar for dollar, with gold coin. In the first case, the notes become the elastic credit currency contemplated by the Federal Reserve Act. In the second case, they are, to all intents and purposes, on the footing of the familiar gold certificates, issued by the treasury against an equivalent deposit of gold in the government vaults at Washington. Now, when the \$176,000,000 Federal Reserve notes, as of July 1, 1916, are analyzed, the remarkable fact appears that

only $10,200,000 of them were the elastic currency secured by commercial paper, whereas $165,800,000 were the circulating equivalent of actual gold. Six months later, the amount of such notes outstanding, based on merchants' credits, was even less.

As to why the banks should have preferred to issue notes through pledging gold against them, dollar for dollar, instead of securing them with 40 per cent gold and the balance in commercial paper, the answer is simple. Because of its enormous exports to belligerent Europe, and of its position as a secure neutral custodian of treasure, the United States imported during 1915 no less than $451,900,000 of foreign gold, or nearly $300,000,000 beyond any previous year; and, in addition, it produced from its own gold-mines nearly $100,000,000 more. The banks had actually more gold in their vaults at the end of 1915 than they had need to use as a basis for their loans to American finance and industry. Therefore they chose, for the convenience of their customers, to put a considerable part of it into general hand-to-hand circulation in the form of notes.

The total stock of money in the United States increased $429,000,000 during 1915. But the increase in gold alone, as I have shown, was a very much larger figure. Precisely the same was true of 1916. The paper currency had actually de-

creased. If we were living under "currency inflation," it must have been inflation in the form of gold. But an increase in the proportion of gold to the total currency of a country is commonly accepted as evidence of financial soundness. These very significant statistics prove that American finance was not under the influence of such inflated paper currency as existed in belligerent Europe. They prove that, in so far as changes in this country's money supply were a factor in the industrial and financial movement, it was the increase in our stock of gold which did the work.

This, however, does not put an end to discussion about the future. In the first place, the very fact that the new banking system's large potential facilities for increasing currency and credits had not yet been invoked is proof that the possibility of using them, and conceivably of misusing them, remained. From this we are primarily protected, as the conservative central banks of Europe have always been, by the large experience and the sober conception of their duties on the part of the men who direct the Federal Reserve, and by the very great restrictive power over the system's credit and currency facilities which the law has conferred upon them. But in the second place, quite aside from the question of actual expansion of paper-money issues, there will remain, until the period of post-

bellum readjustment is well under way, the uncertainty as to the permanency of our present gold reserve. In so far as these huge additions to our stock of gold, like the international capital which they represent, have come to this country for safe-keeping in war time, it cannot be certain how much of it will be retained when the war is over and when Europe will do its best to draw gold from the United States.

Theoretically, it could accomplish that purpose by such enormous export of merchandise to America as should turn the foreign exchanges against us. It could do it through similarly large sales of its own securities to New York. Or it could get the gold by maintaining such high money rates on European markets, in the face of easy money here, that large amounts of capital, now put out on loan in this country, would be withdrawn and offered at the higher rates in Europe.

These are all possibilities; it is therefore a theoretical possibility that so much gold would be drawn away as to deplete our own bank reserves and disturb our markets seriously. It is extremely doubtful, however, in my judgment, whether these results, in such shape as to create actual embarrassment, can be described as probabilities. Europe cannot reverse our balance of trade in merchandise, unless its own need of American products decreases very greatly, or

unless wages of European labor can be put down again so as to undersell our manufacturers. Europe will undoubtedly succeed in selling large amounts of securities in America after peace; but America is not compelled to buy any more of them than is prudent.

As for the question of a high bid through European money rates, it is at least an open question whether money will be high or low in Europe when the war is over. Hard times and prolonged industrial depression in the present belligerent communities will follow this war, as they followed the Napoleonic wars, and industrial depression does not favor high money rates. Furthermore, even if London and Paris and Berlin were to bid for our gold in this manner, it would remain to see what response our own money markets would make, under the influence of the Federal Reserve Banks, which have large powers, through their control over our own money markets, to regulate and restrain the movement of our gold. That will possibly be the first occasion when the power of this novel institution in our financial history will be fully tested.

The special problems which inflated and depreciated currencies will create for Europe, when the war is over, are far more formidable. One of the highest French economic authorities predicted, during 1915, that ten years would probably be

needed to bring the currency of France back to a normal basis. Germany will be confronted, not only with her hugely expanded imperial bank-note issues, but with the makeshift currency of the "loan banks." In our Civil War, depreciation of the paper currency drove out of circulation, first the gold and then the small silver currency. When our people had been reduced to the use of postage-stamps in making petty payments, the government intervened with issues of paper notes for fractions of a dollar. On the European Continent a precisely similar evidence of depreciation made its appearance during 1915.

In France, for instance, municipalities put out paper notes for a franc or less, convertible into notes of the Bank of France. All this structure of inflated currency must be taken in hand by the European governments when war is over. The process will be economically difficult—not only because contraction after inflation is always a trying experience, but because resumption of gold payments on a depreciated currency is usually effected through large governmental loans, whereas the strain on the public credit of the present belligerents has been quite unprecedented. To what extent the accumulations of gold, obtained by continental governments through the voluntary action of their citizens, will serve to facilitate or hasten the subsequent return to specie payments,

is itself a matter of conjecture. These new gold reserves may be needed for other purposes also. The outcome will in all probability be a financial chapter such as will cover many years after return of peace. It will not be the less interesting a chapter in economic history, when it is practically a certainty that at least a great part of the needlessly large war-time accumulation of gold in the United States will in due course, and probably to our own financial advantage, move back to Europe.

CHAPTER IX

THE FOREIGN EXCHANGES

NOTHING in the economic history of this war has been more profoundly interesting than the action of the foreign exchanges. The unprecedented scope of the movements which occurred with such swiftness and violence in 1915, not only threw fresh light on the principles of economic science, but in the popular view a wide political significance was imputed to them. What was described as the sensational depreciation of exchange on Germany in the neutral markets of the world, those neutral markets accepted very generally as evidence of rapidly increasing weakness in Germany's position. When exchange on London at New York, a few months later, suffered a similar spectacular depreciation, the inference was widely drawn that the financial strain of war on England had approached the breaking-point. However much these popular assumptions may have exaggerated the economic situation, and notwithstanding the rejection of them by economists in the nations immediately concerned, the governments showed grave uneasiness. Of-

ficial action, sometimes of a character new to economic history, was taken to arrest the movement. Not only was the public credit employed for this purpose, but in two of the most powerful belligerent states, the investment securities of private citizens were taken into control of the national treasury and sold or pledged by the government to regulate the foreign exchanges.

To the ordinary observer of events, the foreign exchange market is always apt to seem a network of bewildering technicalities. Most well-informed people know, in a general way, that an emphatic movement of exchange rates against a given country, on the other great money markets of the world, is a sign that financial conditions in that country, and sometimes political conditions, are unfavorable. Such action of the foreign exchange market is recognized as a sign that invested capital is leaving the country. Every one at all familiar with business affairs is also aware that a great increase of a country's export trade, in a given season, helps toward the favorable movement of the foreign exchanges, and that decreased exports will have the opposite effect. But beyond these very general conceptions, the exchange market is quite commonly regarded as an intricate puzzle, which may as well be left for discussion by specialists.

Yet the principles which underlie the fluctu-

ations of foreign exchange are in reality very simple, and my reason for reviewing them here is that the meaning of the remarkable war-time phenomena of 1914 and 1915 can be understood only through clear insight into the actual machinery of the market. The intrinsic value of the British sovereign in American money being \$4 86⅝, of the French franc 19.3 cents, and of the German mark 23.8 cents, those values necessarily represent the normal parity at which such European currencies may be exchanged for American dollars. When payments due from the American to the English market, for example, equally balance the payments due from England to the United States, the rate of exchange on the open market will be the intrinsic parity of \$4.86⅝ to the pound sterling. In such case the total sum of drafts by each market on the other would be exactly equivalent to the credits available in each market for account of the other. But if payments due from one side are greater than from the other, the more largely indebted market must then, in order to make remittances, bid for drafts of international bankers on their private funds, and the rate asked by them will vary from the par of exchange in proportion as demand for ordinary trade remittances exceeds supply

Such excess of payments due from one market to the other might be met by sending gold. But

in sending gold, the banker must reckon up the cost of freight, insurance, and loss of interest on the gold while in transit. He can afford to send it only when the rate bid by merchants, for the drafts on the credit established by the gold, has varied so far from intrinsic parity that the difference will cover the cost of shipment. That rate is known in the market as the "gold point." Whereas the par of American exchange on London is $4.86⅝ to the pound sterling, a rate of about $4.83½ is the point at which gold can ordinarily be sent from London to New York. The exchange banker contracts to give to his London clients, in the form of a New York "dollar credit," about three cents less, for every pound sterling paid to him at London, than the exported English gold will exchange for at New York. The three cent discount measures the cost of shipping it. So long, therefore, as gold is freely supplied in ordinary times by banks of a given country to their large depositors, the inequality of payments due between two markets cannot force any larger variation of exchange rates from parity. The debit or credit balance, as the case may be, will be adjusted by export of gold from one market to the other.

These principles lie at the root of the whole remarkable episode of 1915 in the foreign exchange market. What happened was that New

York exchange on London instead of stopping at the normal "gold point" of, say $4.83½ (which it reached in January, 1915), fell by the middle of February to $4.79, a figure never reached before, except for a moment in the disastrous panic of 1857. At the end of June it had touched $4.76; at the opening of September it was quoted at the extraordinary rate of $4.50, with some transactions reported as low as $4.48. This was the furthest point to which the exchange market went in its abnormal movement against London. But it represented a depreciation of nearly 8 per cent, and was a wholly impossible rate if international credit and international exchange of gold were on the footing of normal times. But, exceptionally violent as was this movement of exchange on London, quoted in the greatest neutral market, the other belligerent states had worse conditions to confront in foreign exchange. As against the 8 per cent depreciation in New York exchange on London, the New York rate on Paris at one time in 1915 recorded a depreciation of 17¼ per cent, while the rate on Berlin was quoted 25⅜ per cent below normal parity. Austrian exchange sold at a discount of 40½ per cent, Russian exchange at a discount of nearly 60.

What, then, was the actual economic meaning of so remarkable and, for the belligerent countries so general, an adverse movement of exchange?

In the case of England and France, their purchases from the United States, first of grain and then of war munitions, created so huge a surplus of merchandise imports over exports that the pendulum of exchange was bound to swing heavily against their markets. Nor did the immensely increased import trade of the two European belligerents from America tell the whole story of the "merchandise balance." While such imports, during 1915, ran something like $700,000,000 beyond 1913, the last preceding year of peace, the export trade of the belligerent countries decreased with similar rapidity. Their productive energies were curtailed by the heavy drain on able-bodied labor, first by the army and then by the munitions factories; so that, from this and other causes, merchandise exports from England alone decreased from 1913 no less than $700,000,000, or 26 per cent.

The course of events in France was precisely similar. This unparalleled increase in annual payments due on merchandise account to the outside world in general, and to the United States in particular, occurred at the moment when the supply of remittances from America, to pay for the $200,000,000 or more per annum in the expenditure of American tourists, had been suddenly and almost completely cut off by the war, and when the transfer of capital from London to

New York—especially balances owned by merchants or bankers with headquarters in other markets—was reaching large proportions. We have already seen how London's partial abandonment of its functions as the money centre of the world made this shifting of capital inevitable. But every such transfer necessitated further increase in the demand for drafts on New York, and emphasized the balance adverse to London in the exchange market. The movement was greatly stimulated by the contrast between the war taxes and restrictions on investment which were imposed on capital at London, and the free opportunity for its use in a prosperous and peaceful market, which New York presented. The "balance of trade" against France and England had never been so great in their history.

Still, it will be remarked that in the case of England (and the same was true of all the other belligerents) the actual rate at which their currency exchanged in 1915 for that of a prosperous neutral state was a rate which would have been impossible if gold had been exported in such quantity as to make good the international balance. It followed necessarily, therefore, either that gold was not thus exported or that it was not shipped in sufficient quantity. As a matter of fact, London alone continued to export gold at all, to meet its commercial indebtedness abroad. I have

shown in a previous chapter how large were these shipments to New York on England's account; in 1915 they exceeded $300,000,000; in 1916 they were even larger. But they were evidently not large enough. The $61,000,000 gold, for instance, imported by the United States in August, 1915, and mostly sent from those two quarters, was far from sufficient to restore the international balance and prevent exchange from touching the most unfavorable rate of all at the opening of September. It is questionable whether gold enough to correct by itself the disparity in exchange could have been obtained in London without virtually exhausting the reserve of the Bank of England. Therefore, other means had to be employed to correct the depreciation in exchange.

In September the British Government sent to this country a commission of eminent financiers, with the purpose of floating here a loan of large proportions. Originally, the commissioners proposed that the American investment markets purchase $1,000,000,000 worth of five-year bonds, guaranteed jointly by the English and French Governments. Bankers before whom this proposal was laid demurred to the amount. The sum was very large; even the United States Government had never in its history asked for that much in a single loan from investors of this country. Furthermore, our investors were not familiar with

foreign securities. The entire proposal was vigorously opposed by pro-German interests; there was talk even of a protest from the German embassy. The amount applied for was finally reduced to $500,000,000.

On the other hand, the terms of the loan embodied remarkable concessions. It was to pay 5 per cent interest, as against the 4½ per cent rate of the latest British domestic war loan and the 2½ per cent rate of the old consols; it was offered at 96, as against a price of par for the recent war loan. With five years to run, the loan was to be payable, interest and principal, in American gold coin in this country. Unlike all previous British Government loans, it was to be exempt from the English income tax. When it was considered that, almost within a year, Great Britain had placed a new loan at 3 per cent and France a loan at 3½, the concessions were very noteworthy.

Yet they had seemed to be called for by the situation. Even among people who were in sympathy with England in the war, there was much discussion of whether so huge a diversion of American capital to a foreign investment might not affect our own markets adversely, and whether the strain on England's financial resources might not impair the soundness of this loan. In many minds, the depreciation of exchange on London

was imagined to reflect depreciation of the English Government's public credit.

It was these apprehensions which, at the outset, threw on the prospect of a successful public subscription to so great a loan sufficient doubt to make unusually attractive terms an essential recourse. A week or two of discussion cleared up a good deal of misunderstanding. The public began to realize that when the British Government had just raised $3,000,000,000 on a single loan at home, and had added $1,500,000,000 to England's annual budget of taxation, it was hardly to be supposed that it could not, even without the joint guarantee of France, provide for a $500,000,000 foreign loan. That the fall in foreign exchange on London did not mean England's inability to pay its foreign debts, but merely its inability to meet them through gold exports, began to be understood. So did the fact that even suspension of gold redemption for the currency would not signify, with England of 1915 any more than with the United States of 1865, that the government could not easily pay in gold the interest and principal on its public debt. The loan was floated successfully during the autumn months of 1915.

It was clearly avowed, while the negotiations were in progress, that the purpose of the $500,000,000 loan was to stop the depreciation of exchange on London. It was not understood by

everybody, even then, how the loan could have that effect. The principle involved was, however, plain enough. The violence of the adverse movement in exchange had been caused very largely by the payments made from London to New York for the British Government's purchases of war material. The drafts on London for that purpose had completely upset the market for international exchange. Now, with a $500,000,000 credit established in the United States, as a result of the new loan, the British and French Governments might pay the munition bills up to that amount, not with drafts on London but with checks on the American banks in which the proceeds of the loan had been deposited To that extent the unwieldy surplus of bills of exchange drawn against London was bound to be reduced. The rate of exchange, in fact, moved at once in London's favor, going in a very short time from $4.50 to a fraction above $4.75, around which slightly depreciated level it remained throughout the ensuing twelvemonth.

From the view-point of exchange on London, then, the Anglo-French loan achieved its purpose. It did not have the predicted adverse effect on our own investment market or on the New York money rate; but for this one reason was, that the proceeds were deposited with American banks until the British Government should draw on

them to make its payments, and that when it did thus draw, the money was transferred from American deposit banks to American manufacturers. The argument that the loan was not a sure and safe investment, that the borrowing governments might perhaps not be able to pay it at maturity, lasted longer than the other. This notion was a not wholly unnatural outgrowth from the bewildering evidence of economic strain, as the war continued. No argument, however, could well have been more absurd. Seeing that interest and principal were expressly made payable in gold and at New York, fulfilment of the contract was necessarily a measure of the international solvency of the two great borrowers. In effect, even if not in form, this loan for $500,000,000 was a first lien, not only on the thrifty French Republic but on the British Empire, and on the total resources of those English citizens who added $1,500,000,000 to their annual tax-roll during the first two years of war.

In course of time, the credit balance thus established in America was drawn down by the accruing payments for munitions. The London bankers provided for this condition in advance by raising a $50,000,000 loan on their own account from New York bankers, and by drawing on this fund also, whenever the rate of exchange showed signs of once more moving against London. A

few months later the British treasury intervened with a very remarkable undertaking. Something of the adverse balance of exchange had been met through sales by English investors of their American securities to New York. Up to the middle of 1916, $1,500,000,000 of these stocks and bonds were believed to have been thus resold. From time to time, however, the selling movement slackened; it began to seem as if the English investor was disposed to keep what was left.

A thorough and careful estimate by an American railway president, based on investigation of the amount of our railway securities which were registered in foreign names and reported under the income-tax provisions, indicated that $2,223,500,000 of them were still owned abroad in the middle of 1915. At least $1,750,000,000 must have remained in foreign hands at the end of the year, in addition to an amount of our industrial securities perhaps one-half as great; and English investors undoubtedly owned the bulk of them. Early in 1916 the British Government appealed to such English holders to sell all their American securities to the government at prices close to those of the current market, or to lend them to the treasury, for the period of war and on stipulated terms.

The obvious purpose was to place the government itself in a position enabling it to insure the sale of these securities in New York whenever its

New York credit balance needed to be increased, or to use the securities as a basis on which to borrow in New York. Both expedients were largely utilized. The French Government, following suit, collected from its own citizens a mass of foreign securities, large enough to serve as collateral for a loan of $100,000,000 in New York. So far was the undertaking carried by Great Britain that, later in 1916, the already very high income tax was increased by 10 per cent in the case of income derived from certain foreign securities; this for the purpose, plainly avowed by the government itself, of forcing holders of such stocks and bonds to deliver them to the treasury, whether they wished to give them up or not. The immediate sequel to this action, and to the large deposits of such securities, was the borrowing by the British Government in this country, during August, 1916, of $250,000,000, secured by pledge with a New York trust company of $100,000,000 American stocks and bonds, $100,000,000 Canadian securities, and $100,000,000 bonds of neutral states.

This series of extraordinary economic measures, applied by England and France to offset the potent influences operating to depreciate their exchange markets, achieved their purpose in the case of England to the extent of cancelling the greater part of that depreciation and holding the exchange rate steady. In the case of France, the effort was

less successful; the improvement of exchange, after the most unfavorable rate had been touched early in 1916, still left the market, in the middle of that year, at a discount of 14 or 15 per cent from parity. The failure to accomplish the desired result may doubtless be ascribed in large degree to the fact that the French market lacked the economic resources of England; in particular, that its holdings of American securities, available for sale on the New York market, were trifling in comparison with those of England—for years a habitual investor on an enormous scale in our stocks and bonds.

But another important influence, which did not prevail at London, operated at Paris to prevent correction of the depreciation in exchange. This was the fact that, since French paper bank-note currency had been prodigiously inflated, and since redemption of that currency in gold had been tacitly abandoned, the foreign exchange rates must have reflected not only the abnormal "trade balance" against the French Republic, not only the flight of foreign capital, and not only loss of the annual drafts on New York banks to pay for American tourists' expenditures, but an actual depreciation of the currency. It was exchange on Berlin, however, whose movement brought this aspect of the economic situation into sharpest controversy.

German exchange, as I have shown, was more seriously depreciated than exchange on either London or Paris. As against its intrinsic value of 23⅞ cents in American currency, the exchange value of the German mark fell to 17¾ cents in 1915. Recovering slightly from that very depreciated level, the rate fell lower still in 1916, and the market for Austrian exchange moved similarly. The actual situation of Germany's foreign trade, during the war, was such as to make somewhat less simple the explanation for this movement of exchange. Whereas one perfectly obvious reason for the depreciation of English and French exchange was the enormous war-time "balance of merchandise trade" against those nations, the ocean trade of Germany virtually ceased in the early autumn of 1914, when her ships were driven from the sea and her ports blockaded by the English fleet.

It has been a very general contention, on the part of German economists and financiers, that this embargo on the country's foreign trade accounts for the fact that exchange depreciated more violently and persistently at Berlin than at Paris or London. A common saying, in the foreign exchange market itself, was that the absence of international trade in merchandise made the market for New York exchange on Germany purely "nominal," because there were virtually no commercial transactions on which to base the

rate. But this is scarcely a valid explanation; the exchange was equally depreciated in every other great neutral market of the world. Even supposing Germany's foreign trade to have ceased entirely, bankers' drafts between Berlin and neutral markets (by wireless telegraph or otherwise) would still be feasible. The determining influence on exchange rates would still, therefore, be the excess of payments actually made between Germany and those outside markets. If Germany had in time of peace been accustomed to export more merchandise than she imported, cessation of that trade would, *ipso facto*, operate to her disadvantage on exchange. But the case was precisely opposite with Germany's foreign trade in time of peace; imports largely exceeded exports.

While, moreover, the depreciation in English and French exchange was largely attributable to enormous purchases of war material in America, that influence at any rate was wholly absent in the case of Germany. The Western hemisphere could not have sent munitions to Hamburg or Bremen, however much it might have desired to do so. To the extent, therefore, that payments for these "munitions shipments" were a factor in exchange, the New York rate on Berlin should have depreciated less, not more, than the rate on London or Paris.

Notwithstanding the many cross-currents and

unseen influences bearing on international exchange, it is impossible to escape the conclusion that the depreciation in the German rate measured largely, and in fact primarily, depreciation of the German currency. I have shown in a previous chapter, while discussing the actual status of that currency, the reasons why the currency was depreciated, and why such depreciation was bound to reflect itself in the foreign exchange market. Briefly summed up, the well-known facts are, that Germany's paper currency had been enormously inflated; that redemption in gold, even of imperial bank-note issues, was suspended when the war began, that an actual premium was apparently at one time bid on gold; that such bids were then made a penal offense by the German Government, that the American purchaser of a draft payable at Berlin knew, therefore, that the draft would be paid, not in gold or its equivalent, but in paper currency, irredeemable to-day and with no future date assigned for its redemption.

All of these facts being perfectly understood in the exchange market, it would be on its face incredible that an American banker, purchasing such a draft with American money redeemable in gold, should pay for it what he paid when he could get gold in return for it at Berlin. In a closely parallel historic instance, when the Bank of Eng-

land, in the Napoleonic War, had suspended gold redemption of its notes, and when exchange on London at important foreign cities had gone to 20 per cent discount, there were merchants who protested that the whole depreciation was due to Napoleon's embargo on English trade with northern Europe. A very eminent banker, testifying before a parliamentary committee, thought otherwise. Although the depreciation in exchange might have originally occurred "in consequence of the measures of the enemy," he ascribed "its not having recovered to the circumstance of the paper of England not being exchangeable for cash." The committee indorsed this view, despite its unpopularity in commercial London, concluding that the "rise in the market price of gold in this country, coupled with so remarkable a depression in our exchanges, . . . pointed to something in the state of our own domestic currency as the cause of both appearances." The case of Germany is identical, except that, unlike the England of 1809, she has suppressed the premium on gold by law.

It has been urged, in arguments against this somewhat obvious conclusion, that the blockade had prevented Germany from regulating its exchange market through exporting gold, like England, or through placing loans with neutral states, like both France and England. But a govern-

ment which has formally suspended gold payments does not usually export gold, even if opportunity admits, and Germany's attempt to send gold in moderate amounts to near-by neutral markets, with the view of drawing on the fund thus established and supporting the exchange rate, met with early failure. As for selling to investors of neutral markets the new government securities of Germany, the experiment was tried.

The German Government actually placed some $25,000,000 of short-term notes in the American market, and efforts were made to interest American investors in the large German war loans. But the last-named and larger undertaking failed of success, as an offer by any other belligerent, of neutral participation on a large scale in its domestic war loans, would have failed. Such participation in the German war loans meant that, since interest and principal were payable at Berlin and in current German funds, the American holder would actually receive his interest only after deducting the abnormal discount on exchange. Our people were sometimes urged to invest on the ground that the same depreciation in exchange enabled them to buy the German war bonds at a lower figure than their nominal price of issue at Berlin, and that the post-bellum recovery of exchange to normal rates would therefore amount, in the American investor's case, to a

great increase in value of the bonds. But this was clearly enough at bottom a speculation in exchange. No one could surely say what would be the status of the German currency even on return of peace, and therefore nobody could predict with confidence what the rate of exchange would be.

But behind all technical and specific causes for the war-time movement of the foreign exchanges on the belligerent countries stands the fact that it must reflect, both actually and relatively, the impairment of their economic resources. The question, how long a time will be required, after peace, before the economic effects of this process of depletion shall have been corrected, is one of the large economic uncertainties of the future. What we know is that France, Germany, Austria, and Russia will have to wrestle with that problem as no other great nations have had to wrestle with it since the United States emerged from the Civil War.

CHAPTER X

WHEN THE WAR ENDS

LONG before the European War had completed its second year, the question of how it might be ended, of what the terms of settlement would be, of how return of peace would affect the political and economic situation, had been anxiously discussed by the people of neutral as well as of belligerent nations. The question of peace itself had drawn forth official utterances from statesmen of the fighting Powers, as early as 1915. The British premier, answering Parliamentary inquiries on December 8 that year, merely stated that "if proposals of serious character for a general peace are put forth by the enemy governments, either directly or through neutral Powers, they will be discussed by the allied governments." The German chancellor, after an equally non-committal pledge to the Reichstag, on December 9, of his government's willingness to consider the enemy's appeal, complained that this enemy "has not approached us with suggestions of peace," a fact presumably due to "self-deception beyond compare"; and that,

"so long as belief that Germany is approaching collapse continues to be the dominant idea in enemy countries, it would be folly for Germany to take the initiative."

This last remark referred to various public utterances of the enemy, but perhaps especially to the declaration of December 5 in the Paris Chamber, by the legislative spokesman of the French War Department, that "there will be no peace until Alsace and Lorraine are won, Belgium and Servia restored, German imperialism and Prussian militarism put beyond the possibility of resurrection." There was left by way of peace proposals, after these not very illuminating utterances, the sullen demands of the Opposition party (notably at Berlin) for the government to state its explicit terms, and the performances of the shipload of eccentric philanthropists sent to Europe in the summer of 1915 by an American millionaire.

But people familiar with history recalled, as regards the Opposition protests, that in 1864 even the Republican party's executive committee urged Mr. Lincoln (unsuccessfully) to offer peace to Jefferson Davis on condition that deference to the Constitution be professed. The grotesque incident of the "peace ship" could be matched by the visit to the Confederate capital of a militant Northern clergyman, with a powerful backing, to

settle the Civil War through the influence of the Methodist Church. Even the European governments' public attitude of 1915, in regard to the rumored proposals for peace negotiations, was fairly anticipated when Napoleon, rejecting in 1813 the only possible policy which could immediately have ended that period's European war, declared that "I wish for peace, it is necessary to the world"; but "I shall never make any peace except one suited to the interests of my empire." In short, the world was merely witnessing the usual order of events.

Along with the conflicting public utterances of the statesmen it became increasingly evident, as the war went on, how divergent were the views entertained by the world at large regarding its termination. The great body of humane sentiment undoubtedly held the ground that war could not be ended too soon; that the civilized world must be relieved from this frightful incubus; that peace, however achieved, was a paramount necessity of civilization. There was also visible, however, even in peaceful neutral communities, a feeling that the war ought not to be allowed to end until Germany should have been made to suffer the humiliation suited to a government which, for its own ambitious purposes and under the domination of a military cabal, had provoked such a conflict; whose violation of

treaty, contempt for the recognized rules of modern war, burning of captured cities, exaction of tribute, use of poisonous gases, and murder of non-combatants on the seas, had created a situation in which mere restoration of the *status quo ante bellum* would be mockery.

Looking at the situation from yet another point of view, financial and industrial markets have seemed to change their attitude repeatedly. During the first five or six months of war, when the whole economic world was paralyzed under the influence of the sudden cataclysm, the single opinion seemed to be that nothing could set things right but speedy return of peace. Presently, however, the powerful neutral states began to discover their own exceptional economic advantages. New York received from London its temporarily abandoned sceptre of economic leadership. The world's supply of capital gravitated to America. Our gold supply, our business activities, our export trade, rose to unprecedented magnitude. The foreign exchanges moved in a spectacular way in favor of New York; then came the notable movement of American prosperity.

The word was passed about that this prosperity was bound up with the European War, and that what we had most to fear, by way of a check to that prosperity, was the return of peace. A very exceptional confusion of judgment was the result.

On the stock exchange, whose action is commonly supposed to reflect the opinion of intelligent business men, prices would advance one day on military news which seemed to indicate shortening of the war, yet break sharply the next day on rumors of peace negotiations. All this made the stock market as perplexing a measure of the real situation as were the battle news and the several war-office bulletins, in a month when the furious fighting around Verdun alternated with reports of tentative proposals to end the war.

The "peace rumors" were themselves confusing. In the nature of the case, overtures for peace had to be of the most roundabout and unofficial character; because any government that should publicly and officially ask what terms would be acceptable to its antagonists would thereby suggest on its own part military weakness or weariness of war. There is little doubt, however, that an effort at opening peace negotiations was made through Austria and the Vatican in August, 1915, immediately after the Austro-German army had defeated Russia in the Carpathians and had crossed the Russian border. In official Petrograd, it was positively stated at the time that offers of a separate peace had been made by Germany to Russia. The report of simultaneous overtures, through Austria and the Vatican to the other Allies, drew forth the French premier's declara-

tion to the deputies, in August, that recovery of Alsace-Lorraine and Belgium was the irreducible minimum It is practically certain that in December, when the defeat of Servia had been made complete, Prince von Bülow endeavored to arrange some basis of negotiation in Switzerland

Nothing resulted from any of these overtures Nevertheless—partly because of doubts as to what economic conditions would follow return of peace, and partly because of the enormous profits earned by various American companies through Europe's orders for war munitions—the financial markets undoubtedly seemed at times to regard the prospect of a sudden end to war as an unfavorable influence on values. In particular, the German chancellor's voluntary intimation to our ambassador at Berlin, of the terms of peace which would be acceptable to Germany, was reflected unmistakably on the stock exchange, where prices of the "war munitions shares" fell 5 to 40 per cent within a very few days on the report of that interview.

But when this political incident—followed though it was by reiterated assertions, on the part of German statesmen, of their wish to bring about peace on their own terms—elicited only the reply from the enemy that the terms were not admissible, even the stock exchange lost interest in the matter. Reference to history readily dem-

onstrated that nearly all wars of the past century had been ended only when one completely defeated belligerent sued for peace. It was recalled that all the efforts of the larger European Powers, to intervene or mediate in the Balkan War of 1913, accomplished no more than a temporary truce between the Balkan states and Turkey; that it was only when the Balkan allies attacked one another, and when Bulgaria, rendered helpless by Rumania's armed intervention on the side of Servia, herself asked peace at Bucharest, that the war was definitely terminated. The Boer War, like our own Civil War, ended with the complete defeat of one antagonist, the disintegration of his forces, and the people's acceptance of the terms laid down by the victorious government.

In the Crimean War of 1856, as in the Russo-Turkish War of 1878 and in our own Spanish War of 1898, the defeated belligerent asked for terms. It was the provisional French Government of 1871 that applied for the terms of peace, and had to take what Prussia granted. Even in the case of our government's successful mediation of 1905 between Japan and Russia, with the assent of both belligerents, the financial markets knew that, whatever may have been Japan's economic necessities (and the record has by no means proved them to have been urgent), the larger in-

fluence in promoting a settlement was the pressure applied to Russia by the Paris bankers who were financing her war expenditure, and whose growing uneasiness over the signs, not only of economic difficulties but of coming political collapse in Russia—which, as a matter of fact, occurred only a few months later—was a paramount force in bringing the two antagonists together. There was no one to apply such outside pressure to the present belligerents; they were financing the war themselves.

But that the war would have to end at no very distant date, apparently remained a certainty, and as to what its ending would mean to the financial and economic world, a most striking conflict of opinion continued to prevail; the conflicting judgments being framed, in fact, along two wholly divergent lines of reasoning. According to one of them, this war was itself so immense a calamity, both political and economic, that its ending must introduce financial recovery throughout the world. To American commerce it would reopen the blockaded ports of Europe; in behalf of American finance it would avert the conceivable forced sale in our markets of the one or two thousand millions of American securities still owned in Europe. It would remove at once the overhanging possibility of the European conflict taking a desperately destructive turn, or of the United

States itself being dragged into war. This being so, a spontaneous outburst of relief ought to govern events throughout the economic world Neutral countries would emerge from a period of long suspense, without the prospect of that aftermath of economic exhaustion which belligerent Europe must undergo, with abundant material resources of their own in hand, and with the certainty that Europe must depend on their productive resources for physical rehabilitation.

As against this cheerful forecast, it was asserted by people of the opposite opinion that trade, even in neutral states, had been supported, since the war began, by the military demands of belligerent Europe. Not only must those activities cease instantly with the ending of war, but the fictitious character of the buying demand would at once become evident. European governments would be overloaded with debt and the European people crushed with taxes. How, then, would either of them be able to pay for American exports, if a large export movement were to continue after war? No European state could long postpone the reform of its inflated paper currency, or the removal of those emergency expedients in credit whereby general insolvency was averted in the preliminary strain on credit when the war began. But that is a process of contraction which, as a

good deal of experience has taught, will aggravate hard times.

Furthermore, although prices of American commodities had not been inflated by depreciated currency in the United States, every one of our products used in war (such as copper, lead, zinc, and probably steel) had been abnormally enhanced in price by the military demand—sometimes 100 or 150 per cent from the prices of 1914. Those markets would have to face violent readjustment; prices for the same metals fell 30 to 50 per cent in the first year after Waterloo, although their use for munition purposes had been far less extensive then than now. All home industries using such materials would have a more or less similar experience to undergo.

Demand for our wheat was undoubtedly kept up by the blockade, during more than two years, of wheat exports from Russia, a country which produces one-fourth of the whole world's wheat crop. But Odessa and Riga would be reopened at once to the wheat-consuming world. Not least of all, our manufacturers, responding to the unprecedented demands of Europe, had invested immense sums of capital in plants to produce munitions of war. That trade would practically end with the war. The companies and their shares (whose prices were in 1915 put up 200 to 1,200 per cent on the stock exchange) must come

back to a normal basis, with great incidental disturbance. These considerations, it was usually pointed out, were independent of the other disputed question, What will be the character of Europe's post-bellum competition with our manufacturing industries, whether in the home market or in the export trade?

At the end of 1915, the main question thus disputed was put categorically by a New York newspaper to 26 well-known bankers, manufacturers, economists, government officials, railway managers, and capitalists. Of the answers, 14 were to the effect that American prosperity would continue after peace; 10 were of the opposite opinion; 2 were undecided. This distribution of opinion no doubt reflected accurately enough the judgment of the intelligent general public.

But all the answers pointed to the inference that a period of great perplexity and unsettlement would inevitably follow the ending of the war, and that it must be left for the longer future to determine what this epoch-making war will have meant to economic history. That history, in the past, undoubtedly teaches that the settlement at the end of some of the world's great wars has had profound influence on the future economic position of the nations. Such influence was certainly exerted in the sequel to the Seven Years' War, in which England ousted France from the

American and Asiatic continents; making herself, by the Peace of Paris in 1763, mistress of the Mississippi valley, of Canada and of India, and thereby changing the colonial history of the world. Something of the enormous economic prestige with which England emerged from that celebrated conflict has at times been thought to attach to Prussia after the war of 1871. But in that case, larger allowance is necessary than is usually made for the results of the German imperial unity which followed the victory over France, and which performed for the cumbersome political structure of the German states a good part of what the Constitution of 1787 performed for this country.

It is, in fact, easily possible to be deceived in drawing inferences of this character from successful wars. The question is not always settled by geography and territorial boundaries. Nobody seriously thinks of ascribing our own country's prosperity, in the half-dozen years after 1898, to the acquisition of the Philippines; it would be much easier to prove that the increased prosperity of Spain during the same period was promoted by the loss of them. The addition of the immensely valuable Transvaal states to her colonial dominions, as a sequel to the Boer War of 1899, was followed in England by a period of unquestionably waning economic power. Japan spent

a series of years, after her successful war with Russia, in a state of financial depression.

The truth is, that it needs exceptionally favoring circumstances to make a great war anything but a calamity, in its industrial sequel, to all the combatants. Politically, the rearrangements in the Peace of Westphalia were of high importance; beyond all else they settled, very largely, the long and seemingly hopeless civil conflict on questions of religion. Yet the Thirty Years' War nevertheless left the population of Germany reduced, according to some estimates, by upward of 20 per cent, and it was quite a century before the German states again cut any large figure in Europe. If the great prosperity of the Northern United States, in the half-dozen years after the Civil War, is reckoned an exception, it must never be forgotten what part was played by the railway construction, the opening up of the new West, the increase in the country's agricultural production, the immense immigration—a movement which, in the three last years of the war period itself, more than equalled all the losses of the North in battle, and which was larger still on return of peace.

None of these influences can possibly be duplicated in Europe after this war. They did not affect the whole of our own country, even at the time. So far had the South's economic power

been crushed by the four-year conflict from 1861 to 1865, that with all the spur applied through the pressure of hard times, and with all the urgent demand from home and foreign spinners, to replenish their almost exhausted supplies of raw material, it was not until 1878 that even the American cotton crop again reached the size of that of 1859. "The peace of Europe from the battle of Waterloo to the Crimean War," Thorold Rogers declares in his "Economic Interpretation of History," "was the peace of languor," in which "European nations were recovering from the losses which they had suffered for eighteen years of bloodshed." It is not the least of the problems, whether on the present occasion it will again require the greater part of half a century for economic Europe to get fully on its feet.

CHAPTER XI

THE ECONOMIC AFTERMATH

IF the problem of Europe's political reconstruction when the war is over—the question as to the changes which may be witnessed in the Rhine country, in the Ottoman dominions, in the Balkan states, in Europe's colonial possessions, in that jumble of nationalities known as the Austrian Empire—has been beyond the reach of prophecy during the progress of the war, the problem of Europe's economic reconstruction has been quite as baffling. It is a problem which involves three distinct considerations—the future condition of each belligerent, taken individually; the place which each will hereafter occupy in the world's economic order, and the economic relations of each to the others on return of peace.

All past experience goes to prove that the process of financial readjustment, after the strain of this present war is definitely over, will involve an economic strain of extreme severity, affecting every belligerent. Not only will the artificial stimulus of the prodigious government expenditure be withdrawn, and very suddenly, from the

industries concerned, but there will then arise, in such shape as history has perhaps never before presented, the problem of bringing back to a normal basis the currency and credit systems; inflated and perverted as they have been by the remarkable "emergency expedients" which every government applied at the very outbreak of the war, and has continued to apply in the face of progressive decrease in the stock of accumulated capital. The notion that a prolonged and costly war will be followed ordinarily by prosperity and "boom times," is pure illusion. In the first year after Waterloo the average price of a long list of English commodities fell no less than 30 per cent. Land values came down at a rate which ruined hundreds of owners, speculators, and mortgage-holders. A long series of panicky movements occurred on the stock exchange in the three years after peace. The half-dozen years beginning with June, 1815, were described by a contemporary English historian as a period "of almost unexampled adversity."

Let it be remembered, first, how stupendous is the mass of current international liabilities, payment of which was suspended on the declaration of war. Had the banking-houses, whose maturing credits at other European cities were thus suddenly made unavailable, been left to themselves, bankruptcies on a portentous scale must inevitably

have followed. That result was averted through the use of banking credit, under government guarantee, to an extent never previously known in banking history. But these emergency credits and government guarantees were arranged to end with the period of war. Except where liquidation of other assets has enabled the firms in question to anticipate that settlement, return of peace must bring the hour of reckoning. For the assisted houses must repay the bank or the government, and must look to recoup themselves from their foreign correspondents, who will themselves, at that very time, have their own hands full at home.

Nor is the case very different with the immensely expanded paper currencies. Note circulation of the Banks of France, Germany, Russia, and Italy was expanded $3,500,000,000 in the first full year of hostilities; an increase of no less than 121 per cent, and this not including new paper currency other than bank-note issues. In the same four states, it increased $2,600,000,000 more in the second year of fighting. If these are to be restored to normal proportions when the war is over—if Germany and France especially are to return to a basis of gold redemption for their bank-notes on demand—an extremely trying period will confront the whole of Europe. What the precise attendant phenomena will be, it is not at all easy

to predict. The reasonable certainty is, that the process of readjustment will be long drawn out, and that "emergency expedients" which were to end with the ending of the war will be repeatedly extended. It was six years after the battle of Waterloo before the Bank of England fully resumed gold payments. One of Lloyd-George's predictions to Parliament, when chancellor of the exchequer in 1914, was that the really acute stage of Europe's economic strain is most likely to occur four or five years after the war is over.

Which of the nations will suffer most in this economic reckoning? How will the economic status, relative and actual, of the principal belligerents be affected by the war? When Europe at last emerges from the tornado of bloodshed and destruction, shall we have before us the same economic world as we had in July, 1914, its constituent nationalities occupying the same respective positions as before, and developing their respective energies on the same lines as before; or shall we presently discover that economic positions and relationships of the world have been changed fundamentally, and that a different economic era has begun? These are questions of curious, though as yet little more than speculative, interest.

How the various nations were ranged in the economic order, when this war broke out, every

one knows. England was still indisputably the world's financial and commercial centre. Germany had become an aggressive competitor, however, in the field of home production and foreign trade—so successful a competitor, indeed, as to reduce to outright effrontery Berlin's habitual allegation that this war was necessary to "get a place in the sun" and "obtain the freedom of the seas." France, until the shadow of impending war paralyzed financial confidence, had gained through her people's thrift and her bankers' conservatism a prestige in the world's economic system probably higher than at any time in the preceding century. Paris had in fact financed even the London money market during the acute strain of the Boer War period; had provided Russia with the financial sinews of war for the Manchurian campaigns; had helped out New York (through very large purchases of our new securities) in a troublesome situation as recently as 1910, and had actually been lending enormous sums to Germany's financiers and merchants, when the menacing attitude of the German Government, at Morocco in 1911, forced as an ordinary precaution recall of practically all such credits

The United States was more of an economic puzzle. Its economic prestige in the world at large, immediately after 1898, was undoubtedly

enormous. Having purchased $200,000,000 of England's Boer War loans direct from the British exchequer after 1899—a then unprecedented occurrence—and having reached, two years later, a pinnacle of financial power which seemed unprecedented, our markets listened in 1901 to the Wall Street prediction that New York was about to dispute the world's financial primacy with London.

How premature, if not permanently illusory, were such expectations, we learned four or five years later, when, to sustain the structure of American speculation, our market's outright borrowing from Europe rose to the hundreds of millions; when our financial community was stretched flat on its back in the panic of 1907, and when we seemed, during the three ensuing years, to be chiefly occupied in enlisting European capital to help float new railway securities which our home investors did not show willingness or ability to absorb. But in what position, actual or relative, shall we and the other great states emerge from the epoch-making changes of this war? Of the three belligerents hitherto foremost in financial prestige, it is undoubtedly the prevalent impression that France has given the greatest indication of weakened economic power. For more than a year, her government did not venture to provide for war expenses through important single nego-

tiations of long-term loans. A short-term loan, offered in New York on highly favorable terms to the investor, fell far short of success.

A large proportion of the war expenditure was met, as we have seen, through borrowings by the government from the Bank of France. These signs of economic weakness are the more impressive in view of the economic position of France during the past three decades. The change to her war-time situation is usually ascribed to the circumstances under which the war began—the invasion of France; the practical certainty that, but for Belgium and England, Paris would have fallen; the fact that one of the richest French industrial districts had been occupied by the Germans since the first month of hostilities, and the well-known intimation of influential German statesmen, on numerous occasions since 1871, that the purpose of Germany, in another war, would be to insure the economic ruin of France. It is true that signs of impairment in French economic prestige had been pretty plainly visible, even before the fateful last week of July, 1914. At a time, that year, when even the London Stock Exchange was dismissing as an absurdity the suggestion of a coming European war, the disturbance which had begun in European finance was commonly ascribed to the unfavorable condition of the Paris market, the hoarding of gold

by the French people, and the virtual failure of a French public loan. But there is very good reason to ascribe even this to the growing timidity of capital, which, with the mysterious prescience of the money market, may instinctively have suspected after the ominous clash with Germany in 1911 that actual attack on France could not be long delayed.

Be this as it may, we have yet to ask how France will emerge from the terrific economic strain of the present war. On that question we have some historical precedent to guide us. France, three times in the two past centuries, has been completely defeated and left in a state of seeming economic exhaustion—at the end of the long campaigns of Louis XIV, at the final overthrow of Napoleon, and at the crushing climax of the Franco-Prussian conflict. In the first, her commercial predominance appeared to have had its *coup de grâce;* in the second, her European empire disintegrated; in the third, a very important part of her own territory and an enormous ransom were exacted. Yet, after each of these experiences, the world witnessed the extraordinary spectacle of France promptly resuming her place in the economic system, and in the end displaying a tangible economic power even greater than before. It is impossible that this should have occurred without the possession of national quali-

ties and individual resources of which her enemies had failed to take account. Perhaps the peculiar character of the French people—their thrift, their imagination, their aptitude as arbiter of good form and good taste among the nations—explains this remarkable result. If so, it is difficult to imagine the France of the longer economic future occupying in the economic system any different position than she has occupied in the past.

What, then, should the enormous strain of the present conflict forebode to Germany? It is certainly not true, as writers and correspondents have occasionally insisted, that Germany is already "bankrupt." Yet the war has brought to financial and industrial Germany an experience to which no other powerful belligerent has been subjected. Germany's economic prestige of the three past decades has originated, first in her power to produce commodities at low cost and of desirable quality, next in her capture of the ocean trade through which these goods were brought to foreign markets. During more than two years the outlet for this production has been blocked; her commercial fleet has ceased to navigate the seas, the main source of Germany's recent economic prestige has literally dried up. "What we now manufacture," one of the foremost German newspapers declared in the early months of 1915, "is no longer the productive goods which meant new

value and increasing national wealth. Now we produce only war material; the work of our hands vanishes in air as powder and lead. We are using up our resources and capital."

This has happened in a community whose accumulation of capital as a nation has been an incident of our own times. Even in the half dozen years before the war began, Germany was a borrower of foreign capital, on an extensive scale, to conduct her domestic industries. The process did not mean poverty, it might mean, and in Germany's case undoubtedly did mean, so rapid an increase in opportunities for profitable industrial expansion that foreign as well as domestic capital could be profitably used. But the war which has stopped abruptly this commercial activity and the resultant accumulation of new capital, is also depleting with immense rapidity the accumulations of the past. If we allow for the financial assistance granted by England to her continental allies, it cannot be doubted that the average daily war expenditure of Germany from her own resources has far exceeded that of any other government in the present conflict. The process of depletion, under these two sets of circumstances, must have been very rapid, even when disguised by the bold credit expedients of the government. Such an experience should lead to a period of very severe economic depression.

Meantime, also, the phenomenon of currency depreciation has appeared in Germany as in no other powerful continental state aside from Russia Her government has been driven, first to formal suspension of specie redemption of its currency, then to the recourse of prohibiting, under penalty of fine and imprisonment, the bidding of a premium on gold or the offering of the currency at a discount.

Revolutionary France of 1789 resorted to the same expedients, yet rose to predominant political and financial power a few years later. But the conditions are not analogous; for the French economic revival, in the earlier years of the Napoleonic régime, was a sign of the orderly utilization of national resources which had never previously been touched, whereas Germany had so far exerted all the powers of scientific taxation, before her resources were subjected to the present strain, that the increase in the army during 1913 (undoubtedly in preparation for this war) was accomplished only by imposing an extraordinary burden, described as the "property levy" or "contribution by property owners," on all the individual wealth of the Empire. A further difficulty in forecasting Germany's power quickly to resume her old position in the race for economic leadership lies partly in the as yet not clearly determined question, how far the country's

notable commercial expansion, since the Franco-Prussian War, was due to peculiar national qualities of industry, inventiveness, and energy, which other nations could not match, and how far to government favor or other artificial stimulus. The financial and industrial prestige of England has its roots in the habits and qualities of the people, as far back as Queen Elizabeth's reign. France displayed in the time of Louis XIV the commercial traits which insure her present position in the economic world. The natural resources and individual qualities which have achieved America's present position among the nations can be traced back at least a century in our history.

But Germany is a newcomer; one may almost describe her as a made-to-order industrial state. Half a century ago, few people would have classed the German nation as a leading factor in the world of economic power and prestige. Hamburg, Frankfort, and Bremen, it is true, had even then a financial history almost as old, and fully as respectable, as that of Venice or London; but the entry of Germany as a whole into the field of world finance hardly antedates 1871. Her remarkable economic expansion, since that date, has taken chiefly the two forms of scientific production and of aggressive commercial development under government auspices. The intrusion

of German industry into the competitive field of the outside world, during the three or four past decades, foreshadowed in an extremely interesting way her methods of aggressive warfare. It is entirely probable that the "German efficiency" which has become proverbial in the history of the war, may find equally vigorous expression in the period of industrial recuperation which must come after the war. Yet the lack of accumulated capital resources at home, the loss of productive laborers in battle, the enormous burden of war-time indebtedness and the new taxation which must come after war is over, will be a peculiarly formidable handicap. Germany will have to meet, in a vastly greater degree than France, the problem of direct industrial and commercial competition with countries which will then be far more abundantly equipped with capital for the purpose.

One of those competitors, after as before the war, will naturally be England. The problem of the economic aftermath in England gains particular interest from what has happened since the war began. It has hardly yet been possible for the world to realize the stupendous loss in economic prestige which London has already suffered. In continental Europe, the things which have happened to its financial and commercial machinery since July, 1914—the moratorium, the closing

of the exchanges, the suspension of gold payments, the recourse to paper currency—had happened before in those communities. But to England the proclamation of a moratorium on debts in August, 1914, the closing of the stock exchange, and the issue of special government paper money, were new and startling occurrences, not only in our generation, but in English financial history since the modern credit system was established.

Not even during the eighteen years of the exhausting Napoleonic War, did financial London resort to any of these expedients. It is true, as I have already recalled, that a great depreciation of sterling exchange occurred in the Napoleonic period on such foreign markets as Amsterdam and Hamburg, and an actual premium on gold at home occurred in the Napoleonic wars. But London had then no rival to dispute its financial primacy; and even so, it was six years after the final fall of Napoleon before the Bank of England was able to resume gold payments. Still more significant has been the voluntary abdication by London, for the period of war, of its place as the world's financial centre.

In the case of no other belligerent, therefore, does the problem of economic after-effects of this present war present more dramatic historical possibilities. The world began to ask in 1915 if the sceptre of financial leadership might not turn

out to have passed permanently from the hands of London; and the astonishing depreciation of exchange rates on that market encouraged the idea. Lombard Street itself, depressed and bewildered as it was at the all but unimaginable succession of events already on the record, believed nothing of the sort. It was entirely confident that both the commercial and the financial prestige of Great Britain will be resumed when the war is over; that London will again be the undisputed money centre of the world. This confident expectation had its basis in three facts. Nothing had occurred to drive English commerce from the seas. However much England's accumulated stock of capital may be reduced by the prodigious waste of war, the proportionate reduction, in the case of her European competitors in finance and trade, will have been vastly greater. The United States, with development of its own resources certain to absorb the greater part of its own accruing capital, cannot for years to come be fitted economically for the world's central money market.

There is force in all three arguments; they are reasonably convincing as to the general question of the "money centre." On the other hand, only the test of the aftermath of war can show just what are to be the logical results of that loss in economic prestige which the English financial

market has had to sustain. It is yet to be determined how much of London's past financial power was due to the supposed invulnerability of the English financial system to any kind of shock. Resale to American markets of more than \$1,500,000,000 worth of the American securities held by English investors—perhaps one-third of all that was owned when war began—marked the visible surrender of one highly important factor in the country's prestige as the financial and economic centre of the world. It is at least a safe prediction that when the war is ended England cannot regain overnight, so to speak, the position which she lost as a consequence of the economic vicissitudes of 1914. It is an easy possibility that New York will retain many of its war-time functions and responsibilities as the central money market for the Western hemisphere.

Beyond that possibility, the predictions of people familiar with the world's economic machinery and economic history are extremely guarded. Undoubtedly, England's primacy has been an outgrowth of her financial system's long unchallenged soundness—which is now, perhaps, in a way impaired. But it is also an outgrowth of her position as the workshop for other nations; of the fact that both her productive facilities and her accumulated capital have for centuries exceeded home requirements; of her free trade with all

the outside world, and of the world-wide predominance of her merchant fleet.

Granting that on this occasion the American financial system will emerge from the war-time period with a prestige superior to that of England—as attested by the depreciation on the exchange market, in terms of American money, of the currencies of all the greatest states of Europe, including England—this country would still hardly duplicate England's position as regards the other attributes. We shall not be, as England of necessity is, primarily the workshop of the outside world. A vast field of home development still awaits our manufacturing output and our capital. We have not dared, and probably shall not dare for many years to come, to try the experiment of free trade. Our legislators have shown no disposition to free the American merchant marine from the fetters which have held it back from full competitive expansion.

The question of future financial relationships between the European Powers which went to war in 1914, brings up other considerations. Predictions were publicly made by European statesmen, almost from the beginning of the war, that those relationships would be settled on the basis of political rancor and resentment. "On the columns of the British Empire," the German finance minister declared to the Reichstag, De-

cember 15, 1915, at the end of an impassioned denunciation of England, "are written in glowing letters the same words as were written on the wall of Belshazzar's palace." This declaration, somewhat rhetorical for a sober and practical bank director, meant on its face that Germany expected to break down Great Britain's colonial system, after if not during the war. "So far as commerce is concerned," the president of the British Board of Trade retorted, in an equally bitter speech to Parliament a week later, "Germany is a beaten nation, and it is for us to see that she does not recover."

There seemed to be little ground for taking seriously either of these emotional assertions. So far from the British Empire showing signs of political or economic disruption, the history of the war has indicated on the one hand, that England's colonial possessions had been drawn in unprecedented loyalty to the mother country, and on the other hand, that England's protection of the ocean trade of her colonies has never in history been so powerfully asserted as in this great war. That trade with Germany may to a certain extent be discountenanced in the immediate aftermath of the conflict, by the people now at war with her, is not impossible. There may be exclusive and preferential tariff alliances, and, in any case, Germany will have a long account to

settle for her part in provoking this war and her manner of conducting it. Belgium, the *Lusitania*, the "air raids," the conspiracy against neutral munitions factories—are episodes which will at least not help the vogue of goods with the label "Made in Germany."

Still, the advantages of trade between nations are reciprocal. England, for instance, exported in the last full year of peace $300,000,000 of merchandise to Germany, of which $203,000,000 was British produce, and the shrinkage in Great Britain's outward trade, during the period of war, resulted to a not at all inconsiderable extent from the embargo on trade with Germany. A correspondent of the London *Economist*, writing in a reminiscent vein, lately recalled that when the Franco-Prussian War was visibly near its end in 1871, "French and German commercial travellers were waiting on the frontiers for the moment when peace should be signed, and there was a great inrush for orders, into both France and Germany, as soon as peace was declared." The world's past experience, at all events, points to the conclusion that future financial and business relations of the great countries of the world will not be permanently determined by the hatreds and revengefulness arising from the war.

Such doubt as has actually arisen, during and since the above-cited declarations of 1915, based

itself on the question whether the analogies of former wars—the subsequent political and economic *rapprochement* of the antagonists of the Napoleonic wars, of our own Civil War, and, to a large extent, even of the Franco-Prussian War—could safely be assumed in the present conflict. The theory of statesmen and writers who answer in the negative is that the breach has been too wide, the just indignation over the wicked provocation of this war too intense, the resentment at Germany's violation of rules of war and dictates of humanity too profound, to make even economic reconciliation possible. This feeling was no doubt rendered more intense because of the prevalent belief that on this occasion, in a degree perhaps unprecedented in the history of war, the problem of financial and economic reconstruction must underlie that of political readjustment. Nothing could better illustrate the formidable part which it may be destined to play than the fact that while the lips of statesmen were sealed regarding the political and territorial aftermath of war, the Allied Powers came voluntarily into the open with a plain and definite declaration of the most extraordinary sort, regarding their purposes as to economic relations with the present enemy on return of peace.

This declaration was made public as a result of the so-called "Economic Conference" of June

17, 1916, at Paris, to which delegates were sent by all of the Allied governments. It set forth, in considerable detail, the general programme which the delegates recommended to their several governments in regard to economic relations with the enemy, first during the actual period of war, next during the period of post-bellum reconstruction, and finally during the permanent period of peace. The first pledge of the Allied delegates was rightful and magnanimous. Needs of those countries which have been "victims of destruction, spoliation, and abusive requisition" should be recognized at the start, with the view of restoring "to such countries as a special privilege" their ruined or sequestered "raw material, industrial and agricultural machinery, live stock, and merchant marine."

This promise to unhappy Belgium, Servia, and Poland was in line with the highest motives that prevailed, first in Russia's challenge to Austria's reckless behavior regarding Servia, and again in England's entry into war when Germany invaded and plundered Belgium. It was not the less honorable to its authors in that it had no word to say of an indemnity to be paid by Germany to Belgium—a penalty merited on the face of things, as no other similar penalty in history has been merited, by the brutal cynicism with which the German Government trampled on treaties of neu-

trality, violated international pledges regarding conduct of modern war, and extorted blood-money tribute in the millions from non-resisting Belgian towns, at the very moment when only the generosity of neutrals was preserving the Belgian people from starvation.

But this was not the really noteworthy part of the Allies' economic programme. In general, the proposals (tentative in so far as they had to await approval of home administrations and legislatures) seemed to be directed toward the blocking of any effort by the Teutonic Powers after war to gain possession, for their own production and export trade, of the markets of their present enemies. The declaration left it more or less a matter of conjecture how far the programme was offensive and how far defensive. Measures were to be taken which would "assure the independence of the Allies" in matters touching "financial, commercial, and maritime organization." The contracting governments were "resolved to take without delay the necessary measures to rid themselves of dependence on enemy countries as regards raw material and manufactured articles which are essential to the normal development of their economic activity." This would apparently indicate merely a form of protection to home industries—at least so far as concerned exclusion of, or discrimination against, importations from Ger-

many or Austria. A considerably longer step was suggested by the statement that, in the period of economic reconstruction, and in order to protect their commerce and industries "against an economic depression resulting from 'dumping' or against any other unfair method of competition," a period should be fixed by the Allies "during which the commerce of the enemy Powers shall be subjected either to prohibition or to a special system which shall be efficacious."

Even this proposal was restricted to the period of transition from abnormal war conditions to the normal state of peace; but the next looked to the longer future. Among what were designated as "permanent measures of mutual aid and collaboration" it was stated that the present Allied governments "may have recourse to subsidized enterprises under the direction or control of the governments," or to "payment to encourage scientific and technical researches," or even to "permanent prohibitions." Finally, as to future relations of the Allied Powers with one another, the conference declared itself united "in preserving for the Allied countries, in preference to all others, their natural resources during the period of commercial, industrial, agricultural, and maritime reconstruction," and agreed for that purpose "to establish special arrangements which will facilitate an exchange of resources."

No series of proposals quite like this had ever before been formulated, either during war or in sequence to it. The declaration at once called forth comment as widely divergent in interpretation as in criticism. By some European critics, it was assumed that the programme was urged primarily by the continental Allies—Russia and Italy in particular—who wished to be guaranteed against falling again under Germany's financial and commercial domination. But there were also intimations that the programme only formulated the British ministerial assertion of the year before that "so far as commerce is concerned, Germany is a beaten nation, and it is for us to see that she does not recover." Against this second theory, the Paris proposals were defended as the erecting of a necessary safeguard against the commercial chaos pictured as a result of Germany's desperate economic situation after war. From yet another point of view, it was alleged that England's proposed participation in this sweeping protective policy embodied a clever move by Bonar Law and his English "Tariff Reformers" to fasten on England, in the stress of war, a tariff system which English voters had steadfastly rejected in time of peace. Even at Washington, the Paris declaration elicited the pointed inquiry whether or not the pledge of the Allies, to preserve by mutual arrangement the

resources of their countries "in preference to all others," pointed to discrimination against the United States.

On the whole, the impression made in neutral communities was that the whole procedure reflected not reasoned conviction based on experience, but the vague apprehension—arising from uncertainty as to what will actually be the world's economic or political situation when war is over—which has colored even our people's judgment as to their own country's situation on return of peace. When experienced statesmen and thinkers were refusing to risk prediction of the economic sequel to this war, no one need have wondered at panicky demands to prepare for anything. The compact to resist the imagined inroads of commercial Germany, after return of peace in Europe, is at least as logical as the demand for an American army large enough to resist her imagined military inroads. The two suppositions are indeed not at all dissimilar; for whereas the one would seem to look for unprecedented military aggression from a nation with shattered army and depleted population, the other assumed an equally unprecedented commercial competition from a country stripped of raw material, denuded of surplus capital, drained of its able-bodied laborers, and saddled with a depreciated currency.

All such considerations were left to get a hear-

ing, when the declaration of the Paris conference should come up for debate before the legislative bodies. But in the meantime, outside observers recognized three aspects of the matter which had apparently received scant consideration from the delegates at Paris. In so far as the proposed agreements were defensive, not offensive, they would amount to confessing fear of the very nation which (supposing the defeat of Germany) had just been conquered. That attitude would at least be novel and anomalous for a victorious coalition. In so far as they were offensive and not defensive, they would be public declaration of economic war, to be made a source of future bitterness, acrimony, and renewed political intrigue, at the very moment when the disastrous military war had been happily concluded.

But in the third place, it was difficult to deny that, while what England, France, Italy, and Russia would gain from exclusion of German trade would be highly problematical, what they would lose would be certain. Back of all questions of "dumping," "commercial invasion," and "balance of trade" stood the quite undeniable fact that Germany, with her thrifty population and her enormous import requirements, will continue to be one of the most profitable markets in the world. It will hardly be supposed that exclusion, partial or complete, of German products from the

Allied markets, would not provoke retaliation in kind on the part of Germany. But if so, then the upshot of such attempts to obstruct by arbitrary edict the normal movement of commercial intercourse would necessarily be to transfer such opportunities, in the rich field of Germany's foreign trade, to neutral markets which were already threatening Great Britain's commercial supremacy. A decision of the Allied countries to dispense with German goods would quite as inevitably compel their own recourse to the American producers on a scale of exceptional magnitude. Even if, under such conditions, English and German exporters should endeavor to find in the American market compensation for their loss of Anglo-German trade, the salient fact would be the further immense advance in commercial prestige by the United States—at the expense of the European markets, yet by the deliberate act of the European Powers.

It was not easy to imagine England, at any rate, embarking on so suicidal a commercial policy. When all the surrounding circumstances were considered, it seemed far more reasonable to suppose that the English delegates primarily indorsed the Paris proposals as in the nature of a threat to Germany of what might happen if her government did not presently come to terms and end the war. The military policies of the Hohen-

zollerns had more than once been halted or diverted by pressure from the commercial interests of the Empire. But this whole question, like the multitude of other uncertainties created during the progress of the war, was bound to remain in the realm of conjecture and dispute until the actual hour of international readjustment should arrive.

It is conceivable that the bitterest animosities of this war will survive into future generations; yet that is not altogether the teaching of the past. Thackeray's celebrated "Waterloo chapter" concluded with a prediction of indefinitely continued political enmity between France and England; but the only two subsequent wars in which both have been engaged have seen their armies fighting side by side against a common antagonist. When the reader of history recalls the Prussian commander's insistence after Waterloo, that Napoleon be put to death by the victorious Allies, or the demand for the South's political subjugation after the Confederate armies had surrendered, or the declaration by the London *Times* in 1814 (when even the British ministry was planning to settle our "War of 1812"), that "to be consistent with ourselves, we must maintain the doctrine of 'No Peace with James Madison,'" he will at least be compelled to acknowledge that the last stages of a bitter and angry conflict are not the

hour when the clearest views of future relationships may be obtained.

No doubt, it was a changed France with which reconciliation became possible to England; a "New South" which opened the way to the Union as this generation knows it, and an altered England whose present relations with the United States have replaced the underlying animosity which the Revolutionary War and the War of 1812 left behind them But this means that if we read by the analogy of history, it will be another and a different Germany with which other nations will reconstruct relationships in the longer future.

CHAPTER XII

EUROPE AND AMERICA

PERHAPS it was the very brilliancy of the economic fortune, brought by the war to the United States, which served to intensify misgiving as to this country's possible situation when the war ends. Even in speeches and convention declarations of the presidential campaign in 1916, reference was constantly made to the "temporary" character of our war-time prosperity. That some essential elements in this sudden prosperity would not outlast the war, nobody denied. We could expect no more $2,000,000,000 "excess of exports." Our huge outward trade in war material of every sort was bound to end on return of peace. Prices for metals and commodities indispensable to war were certain to come down from their extravagant heights. Profits of the shipping trade—which, with the driving of Germany's merchant marine from the sea and the drafting of England's into war service, added 500 or 1,000 per cent to freight rates—will be subject to extensive and perhaps early readjustment. To what extent the ending of the war,

and the release of Europe's fleets for peaceful commerce, would affect our war-time activities in trade with South America and Asia, was at least a problem to be considered.

There were considerations on the other side. Many American industries, cramped for lack of their accustomed raw materials, would be instantly benefited by the ending of the war blockades. The foreign market for our cotton, so largely cut off by the war as to compel reduction of more than 20 per cent in the annual American crop, would be completely reopened. But behind all these generally recognized probabilities there remained one great uncertainty; which, as time went on, occupied more of the American business community's attention. That was the question whether Europe—its people impoverished by war, its manufacturers suddenly deprived of demands for war material, and, in Germany's case, its whole productive industry in touch again with a foreign market lost since the war began—will not instantly pour into the rich United States so immense a mass of manufactured goods, offered at very low prices fixed by the urgent needs of the European producer, as to cut off our own manufacturers from the market. This picture seemed on its face convincing; the result appeared to follow the logic of the situation. Our own government has already begun tentatively to discuss

measures which might be necessary to avert or modify the disorganizing effect on American industry. Platforms of both political parties, as adopted for the presidential campaign of 1916, recognized such an economic sequel to the European War as an imminent possibility.

Many of the circumstances of the day conspired to emphasize such misgivings. The extraordinary situation which, with the prolongation of the war, had arisen throughout the world; the increasing jeopardy to which (as at the similar juncture of the Napoleonic wars) the rights of neutral states and people were subjected; the rising emphasis and bitterness which marked, on the one hand, the feelings of the belligerents toward one another, and, on the other hand, the sympathies of neutrals—all these found expression in the financial as in the political incidents of the day. It is reasonably safe to say that nowhere did they influence news and tinge controversy as in the United States. Our State Department's attitude, the momentary clash of the President with Congress over the "submarine dispute" with Germany, the tense public excitement over the battle news, and the recourse to public meetings convened to urge one policy or another, clearly enough reflected these aspects of the situation. So, also, the repeated agitation and disorder on the stock exchange have reflected them; it has been a very

different picture, since 1916 began, from the unbounded confidence of 1915, when the eyes of Wall Street were fixed almost exclusively on this country's own prosperity. The spread of the political and popular movement for "preparedness" was a natural outcome of the surrounding influences.

For the sudden vogue of the "military preparedness" propaganda, there seemed, in the view of the ordinary calm observer, to be several different causes. One, and undoubtedly the most convincing, was the belief that for actual defensive purposes, our land forces were not such as to admit either of immediate effective resistance or of rapid expansion into an armament which would be effective. This consideration, to be sure, was of itself no more true in 1915 or in 1916 than it was ten years ago, or a quarter of a century ago. Particular incidents of the European War, however, had instilled into the minds of many people the further idea that things may happen in this world of ours whose occurrence we supposed, as recently as the middle of 1914, to be wholly inconceivable. This could not fail to be a powerful secondary influence in the "preparedness" discussion.

Yet no one can have missed the third influence: the presence in the United States (and elsewhere throughout the world) of an emotional hysteria, engendered in very infectious form by the contro-

versies of the war. It has not been easy for any individual to keep himself in hand, so to speak, during this clash of strong emotions—which, as a matter of fact, could not possibly be avoided, even in the every-day conversation of the office, the club, or the dining-table. Coming on top of the actual events of the present war, this violence of feeling, and the inevitable resultant extravagance of inference, rendered peculiarly difficult the sane and sober discussion of problems of national defense.

In many respects, it was these same three influences which aroused discussion over what has received the imitative title of "economic preparedness"—meaning the adjustment of our financial machinery and business methods to whatever conditions may be expected to prevail after the war. Fortunately for the usefulness of the discussion, it was not conducted on the emotional pitch which frequently characterizes the "military preparedness" propaganda. In the field of world-politics, the unexpected events which have occurred since the war began might be construed into a ground for misgiving as to our own country's position. But the unexpected financial events in our country's trade, finance, and industry, were almost wholly of a character to reassure the American mind. Beyond even this, the questions with which the economic problem had to deal were severely

practical, and have to be judged by practical experience—in which they differ considerably from discussions based on the hypothetical possibility of invasion of the United States by the German army.

For one instance, the very familiar and very much overworked assertion that, at the end of the war, the United States would be left without a friend in the world, did not greatly impress the practical financial mind. The man of some experience in affairs, whether at home or internationally, does not expect that a neutral state, lifted to high individual prosperity by the incidents of a foreign war, will be regarded with the kindest of feelings by belligerent nations struggling under the burden of the conflict. Though it is not the neutral's fault, he is certainly gaining where they are losing.

The practical man remembers, if he is familiar with history, that France and England looked with by no means unconcealed irritation at the "business boom" in this country during the early years of the Napoleonic wars, and that the Continent had much the same feeling with regard to England during 1870 and 1871. But the notion that, whatever might be the individual sympathies of our people in the European War, every one of the European belligerents had come to hate the United States, and would be its enemy hereafter

because our government, as a government, had not departed from its neutrality and openly favored one side or the other, could not fail to appeal to intelligent and thoughtful men as a wild absurdity. The slightest reflection on the facts of the situation, as the end of the war drew nearer, would convince him that the financial and political friendship of the United States was certain to be the great prize for which Europe would contend.

Still, it was a curious fact that the practical business man, who rejected out of hand the forecast of an isolated and friendless post-bellum America, began his own "preparedness" discussion with the talk of possible invasion. What he meant, however, was the "dumping" of low-priced European merchandise in this country when the war was over; the "flooding of the American market" with competitive goods; the "economic invasion." Now, invasion of this sort is not a new source of misgiving, even in the minds of statesmen. A quarter of a century ago, not only America but Europe was anxiously discussing a prospective invasion by Asiatic merchandise. When England and the Continent then talked of the "yellow peril," they did not at all mean immigration from China and Japan, but products of Chinese and Japanese manufacture. It was less than two decades ago when the minister of

foreign affairs in a European cabinet, addressing the legislative body, declared that "European nations must close their ranks and fight shoulder to shoulder" if "the vital interests of the European people are not to be gravely compromised," and by nothing less than the threatened invasion of American manufactures.

The fright to which Count Goluchowski's speech gave expression—at a time when American manufacturers, emerging from the panic of 1893, were setting forth to discover in the export trade an outlet which the depressed home market did not offer—disappeared when reviving prosperity in the United States itself relieved the pressure A few months, and the "American peril" was as completely forgotten as the "yellow peril," and the fact may not be without bearing on the present controversy. Yet the incident suggests analogies in both directions. The present belligerent states of Europe will at least repeat, after the war, the case of a depressed home market, and the United States will repeat the case of an inviting objective point for export trade. Is it our business, then, to begin by raising higher and higher protective tariffs in advance of the post-bellum "European invasion"?

The question might be argued on the basis of this country's ambition to retain its present place as the central money market of the world. On

that ground alone, the proposal to begin our career in economic primacy by protecting our own markets against competing foreign nations is a bit anomalous. London's economic primacy of our day was built up on the absolute free-trade policy of England. There are those who believe that the exigencies of war expenditure are already driving England to the familiar "revenue tariff with incidental protection," and our own national experience teaches that such a tariff is a stepping-stone to the protective tariff with incidental revenue. Hypothetically, and as a pure matter of economic strategy, one might suppose that the sceptre of world finance might most surely be grasped by seizing also the weapon with which England won it.

Governmental policies are not always settled nowadays, however, on the basis of general principles. The question must still be answered, whether America will not be "flooded with cheap European merchandise" after the war, and to answer it we have no precedent to guide us. It is true that, in the year when the long Napoleonic conflict in Europe came to an end, this country's merchandise imports rose to $113,000,000, as against $12,900,000 the year before; and that the next year they broke all precedent. But the United States had itself been at war with a European Power, from 1812 to the end of 1814. The

sudden inrush of imported English merchandise, on return of peace, was not then described as an industrial calamity, but as trade revival. The goods were sorely needed, their arrival in our markets foreshadowed business activity and return of better times. Nevertheless, England undoubtedly began then to undersell the outside producing world. Why will not both England and continental Europe, when this war ends, set to work at the same task in order to relieve their own economic burden?

The lesson of the world's experience, thus far in the war, has been that confident prophecy of results from the powerful economic causes, visibly at work, is rash. But that same experience has also shown, as we have seen repeatedly in our narrative, that prediction has been most unlucky when it arose from impulsive expectation of the worst, and when it was based on assumption that the most alarming economic incidents of older wars were bound to be repeated. Keeping in mind these reservations, the first answer to be made to the above-stated question is, that the particular conditions which prevailed in the aftermath of Waterloo can hardly be duplicated. In the dozen years after 1815, the economic history of Europe was a tale of production with labor at starvation wages. Tooke, the economic historian of the period, describes the interval from

1814 to 1816 as one of "losses and failures among the agricultural and commercial and manufacturing and mining and shipping and building interests, which marked that period as one of most extensive suffering and distress." Readers of "Tom Brown" will remember the narrative of the English parish "which had risen into a large town during the war, and upon which the hard years which followed had fallen with a fearful weight"; "masters reducing their establishments, the fearful struggle between the employers and men; the lowering of wages" The memoirs, the histories, even the fiction of the period, are crowded with such dismal facts.

The hard times in Europe will follow this war as they followed that of a century ago; but it is far from being an equal probability that cheap European labor, which was the basis of such "economic invasion" as occurred after 1815, will be a sequel to this war. It was England which, in the vernacular of to-day, "flooded the world's markets" with low-priced manufactures. But England's labor supply had not then been depleted through a continuous, violent, and destructive conflict on the land. The British army's losses in Wellington's Spanish campaign, even if added to the losses at Waterloo, would hardly match the English losses in a single month on the present Western front.

With her present loss of available laborers, and with even women's work in factories largely a temporary expedient of war, the natural outcome, all other influences remaining equal, would be that employers must bid for labor. All other influences may not be equal; it is possible that, in the period of financial exhaustion after war, the home demand for goods will be as much reduced as the supply of labor. Yet, as against even this contingency, there remains the unmistakable fact that the Labor party, even in this time of war, has held the balance of power in the English Parliament, and that, immediately prior to the war, it was dictating minimum wages, through the ministry and Parliament.

But this is not the only consideration bearing on the economic sequel. It is recognized, even in the programme of economic policy adopted by the Allies in 1916, that the first necessity of continental Europe after peace will be immense supplies of new material for reconstruction of its shattered cities, damaged railways, bridges, harbors and fortifications, and overworked industrial establishments. To provide this new material, it will find itself with factories whose machinery has been altered to make guns and ammunition, and with the supply of able-bodied laborers enormously reduced by loss in battle. Demands on Europe's productive energies for the purpose will

be very great; some of our own most experienced manufacturing authorities hold that the circumstances insure an export trade from the United States to Europe, after war is over, of abnormally large proportions. It has been publicly stated, by high authority in Germany's productive industry, that a year and a half, after return of peace, will be required "merely to resupply our countries with the things that have been used up during the war."

In the early part of 1916, the Associated Press correspondent at Berlin interviewed numerous high authorities in German industry on the question, how the German people would be able to bear the heavy burden of taxation, recognized as an inevitable sequel to the war. The director-general of the great Siemens-Halske electrical company replied that the burden would be offset by increased wages. "To-day in Germany," he declared, "wages are unprecedentedly high, and the return of a few million soldier-workmen will not drive them down." A director of the largest private bank in Germany went further, stating it as his opinion that the "heavy taxation following the war will necessitate general advance in both salaries and wages"; a prediction supplemented by a high economic expert with the remark that if the employers will not voluntarily raise wages, then the advance "must be forced by those who

need it." But higher wages are not the road to cheap competitive production.

As for France and Russia, the task of preparing for large purchases from the United States when war is over—especially of mechanical appliances for use in agriculture and other productive industry—has long been under way in its preliminary stages. A careful review of the matter by a well-informed Paris correspondent, at the time, concluded that in France, during the period immediately following return of peace, there will be "no chance for either plentiful or cheap labor for surplus production," and that "for some time after war, demands on the United States, so far as France is concerned, will be quite as large and quite as urgent as during the war itself." This view of the question was publicly confirmed by members of a commission, sent from France as official representatives of the French Government and the various French industries, with the announced purpose of ascertaining how the needs of industrial France, in the period of reconstruction after war, could best be met from the manufacturing facilities of this country. Members of this commission estimated that, for machinery alone, the new orders of this nature might reach $160,000,000.

These aspects of the European situation in regard to labor supply, wage scales, and capacity

for production, may not finally determine the nature of transatlantic competition. There would still remain the problem of what conditions will exist when the period of reconstruction is completed, or of what will be the course of wages in this country. Demands for an increase have been greatly emphasized during the more recent months of war. But I have shown at least that the question, whether Europe will not instantly "dump" its products on our home markets and in our export field, at prices with which American industry cannot compete, is by no means one-sided. It cannot be safely determined in advance by the precedent of older wars. How many circumstances peculiar to the present war surround it, may be judged from the single fact that experienced students of the immigration problem have frankly confessed their inability to decide what will be the probable outcome in that field—an unprecedented rush of European peasants and laborers to the United States, to escape, once for all, the horrors of militant Europe; or wages in industrial Europe, high enough to retain its laborers, or, possibly, outright governmental embargo on emigration from the countries of continental Europe That expedient would be new to Europe's history, yet no more unprecedented than many another expedient already actually adopted, in the war period itself.

Such are the interesting and unusual elements of uncertainty which surround the question of the conditions which, in our own country as in belligerent Europe, will arise with return of peace. It is undoubtedly fortunate that the American people themselves have lent a readier ear to prediction of possible danger than to prediction of unchecked American prosperity. Merchants and manufacturers who have been gaining the largest profits have been the most conservative in guarding their financial position against the possible great reaction. Speculation on the stock exchanges, not only in shares of war munitions manufactories but in securities of companies conducting the business of ordinary times, was held in check even at the height of the rise in prices during 1915. If the misgivings expressed so widely regarding the economic sequel in the United States were all to be fulfilled in the event, the result would at least not take our financial and industrial community unprepared.

The country itself is prepared in still other ways for whatever vicissitudes the aftermath of war may bring to it. The undoubtedly immense expansion of credit has been based on an unprecedented accumulation of gold. The abnormally great increase of our exports to belligerent Europe has been offset by repurchase of possibly the greater part of the securities representing our

standing indebtedness to the outside world. If the strain of economic reconstruction in Europe is to affect the American money market, we have the machinery of a sound and scientific banking system, with its facilities ready for instant use and as yet hardly employed. It is these well-known facts which are the basis for the statement, by one of the most experienced members of the Federal Reserve Board, that "the United States have so strengthened their economic position among the nations of the world that, to a substantial extent, they must take the place of the European nations which acted as the world's bankers before the war."

Out of the numerous predictions made when the war broke out—most of which, as we have learned in the course of our narrative, turned out to be mistaken—the one prediction accepted unanimously by thoughtful men was that the world which emerges from this epoch-making conflict will not be the world which we knew before 1914. This prediction was most frequently made of political institutions and relations; sometimes of social institutions. It may be ventured quite as safely in regard to economic institutions and relations. The spirit in which the United States will meet the test of these new conditions may reasonably be one of soberness, but of hope and confidence.

INDEX